Supreme Court, U. S.
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MICHAEL RODAK, JR., CLERK

APPENDIX
Vol. I
Pages 1a to 595a

In The

Supreme Court of the United States

OCTOBER TERM, 1977

Nos. 77-452, 77-457, 77-551, 77-602

MOBIL ALASKA PIPELINE COMPANY, EXXON PIPELINE COMPANY, BP PIPELINES INC. and ARCO PIPE LINE COMPANY,

Petitioners,

—against—

UNITED STATES OF AMERICA, THE INTERSTATE COMMERCE COMMISSION, *et al.*,

Respondents.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITIONS FOR WRITS OF CERTIORARI FILED SEPTEMBER 22, OCTOBER 12, OCTOBER 25, 1977

CERTIORARI GRANTED NOVEMBER 28, 1977

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7/ 6/77	Petition for Review of Order of ICC—*Mobil Alaska*
7/ 6/77	Flg. Petitioner's Application for Temporary Restraining Order—*Mobil Alaska*
7/ 6/77	Flg. Petitioner's Application for Interlocutory Injunction—*Mobil Alaska*
7/ 6/77	Flg. Petitioner's Memorandum in Support of their Applications for Interlocutory Injunction and Temporary Restraining Order—*Mobil Alaska*
7/ 8/77	Petition for Review of Order of ICC—*BP Pipelines*
7/11/77	Motion to Intervene of Sohio Pipe Line Co.—*Mobil Alaska*
7/11/77	Flg. Memorandum of Sohio Pipe Line Co. in Support of Petitioner's Application for Temporary Restraining Order—*Mobil Alaska*
7/11/77	Petition for Review of Order of ICC—*Exxon Pipeline*
7/11/77	Flg. Petitioner's Motion to Stay, Restrain and Suspend Order of I.C.C.—*BP Pipelines*
7/11/77	Flg. Petitioner's Memorandum in Support of Their Motion to Stay, Restrain and Suspend Order of I.C.C.—*BP Pipelines*
7/12/77	Flg. Motion of Exxon Pipeline Co. for Expedited Consideration or, in the Alternative, for a Stay Pending Review, a Memorandum in Support and Appendices to Memorandum in Support—*Exxon Pipeline*
7/12/77	Flg. Motion of State of Alaska for Leave to Appear as Party Pursuant to 28 U.S.C. § 2323, and § 2348, and Rule 15 of FRAP—*Mobil Alaska*
7/12/77	Flg. Reply of I.C.C. in Opposition to Petitioner's Applications for Interlocutory Injunction and Temporary Restraining Order—*Mobil Alaska*

DATE	
7/13/77	Petition for Review of Order of ICC—*ARCO Pipe Line*
7/13/77	Flg. Reply of Respondent, I.C.C., in Opposition to Petitioner's Motion to Stay, Restrain and Suspend Order of I.C.C.—*BP Pipelines*
7/13/77	Flg. Memorandum in Support of Motion of Respondent, U.S.A., to Dismiss Appeal—*Mobil Alaska*
7/13/77	Flg. Memorandum of U.S.A. in Opposition to Applications for Temporary Restraining Order and Interlocutory Injunction—*Mobil Alaska*
7/13/77	Flg. Memorandum of State of Alaska in Opposition to Applications for Interlocutory Injunction and Temporary Restraining Order—*Mobil Alaska*
7/14/77	Motion to Intervene of Arctic Slope Regional Corp.—*Mobil Alaska*
7/14/77	Flg. Memorandum of Arctic Slope Regional Corp. in Opposition to Application for Interlocutory Judgment and Temporary Restraining Order—*Mobil Alaska*
7/14/77	Motion for Injunction [with Memorandum in Support] of ARCO Pipe Line Co.—*ARCO Pipe Line*
7/14/77	Flg. Motion of Respondent, U.S.A., for Consolidation of Nos. 77-2412, 77-2421 and 77-2437 and to Dismiss Petitions —*all cases*
7/14/77	Flg. Telegram Confirmation of Interstate Commerce Commission as Requested by the Ct. with respect to earliest date projected for arrival of oil through pipeline to Valdez—*Mobil Alaska*
7/14/77	Flg. Telegram Confirmation of Mobil Alaska Pipeline Co. as Requested by Ct. with respect to earliest date projected for arrival of oil through pipeline to Valdez—*Mobil Alaska*
7/14/77	Flg. Telegram Confirmation of Exxon Pipeline Co. as Requested by Ct. with respect to earliest date projected for arrival of oil through pipeline to Valdez—*Exxon Pipeline*

DATE

7/14/77 Flg. Telegram Confirmation of ARCO Pipe Line Co. as Requested by Ct. with respect to earliest date projected for arrival of oil through pipeline to Valdez—*ARCO Pipe Line*

7/15/77 Flg. Memorandum of U.S. in Support of Their Motion to Dismiss, also fld. in Nos. 77-2412, 77-2421, and 77-2437—*all cases*

7/18/77 Flg. Mobil Alaska's Reply Memorandum in Support of Application for Temporary Restraining Order and Interlocutory Injunction and Response to Motion to Dismiss. (Copies were mailed directly to Judges' home stations.)—*Mobil Alaska*

7/18/77 Flg. Motion of Amerada Hess for Entry of Appearance as a Party—*Mobil Alaska*

7/18/77 Flg. Exxon's Reply to Motion of USA for Consolidation and Motion to Dismiss (Copies sent directly to Judges' home stations.)—*Exxon Pipeline*

7/19/77 Flg. Reply of ICC in Opposition to ARCO's Application for Interlocutory Injunction, and Exxon's Motion for Expedited Consideration (Copies sent directly to judges' home stations.)—*ARCO Pipe Line and Exxon Pipeline*

7/19/77 Flg. State of Alaska's Supplemental Memorandum in Opposition to Application for TRO and Interlocutory Injunction and in Support of Motion to Dismiss filed by Respondent U.S. (Copies sent directly to home stations.)—*all cases*

7/19/77 Minute Entry: Oral arguments were held in Houston, Texas today on Cases 77-2392, 77-2412, 77-2421 and 77-2437 on the motion to dismiss, temporary restraining order and injunctive relief. The Court granted from the bench the motion to consolidate these cases as well as the motions of all parties to intervene. The motion to dismiss and temporary restraining order and injunctive relief motions were taken with the case. The Panel consisted of Judges Brown, Godbold and Roney. Arguing for Petitioners were: 1) Andrew J. Kilcarr (Mobil Alaska); 2) Richard

DATE

J. Flynn (Exxon); 3) Marvin Schwartz (BP) and 4) Robert Jordan who handled the rebuttal (for ARCO). Arguing for Respondents were: 1) Charles H. White, Jr. (ICC); 2) Donald A. Kaplan (D. of Justice); 3) Avrum Gross (Atty. Gen., Alaska) and 3) Yale Lewis (Arctic Slope)—*Mobil Alaska*

7/22/77 Flg. Suppl. Memorandum of State of Alaska in Opposition to Memorandum in Support of Petition fld. by Intervenor, Amerada Hess Pipeline Corp.—*all cases*

7/25/77 Flg. Motion of Union Alaska Pipeline Company to Appear as a Party—*Mobil Alaska and Exxon Pipeline*

7/29/77 Opinion of Court of Appeals dismissing cases: all motions to intervene granted; all motions for stay, suspension, injunction, etc. denied—*all cases*

8/15/77 Petition for Rehearing En Banc—*BP Pipelines*

8/17/77 Received certified list of all documents submitted to ICC—*all cases*

8/19/77 Flg. Petitioner's Motion for Stay of Mandate Pending Application for Certiorari—*Exxon Pipeline*

8/19/77 Flg. Petitioner's Motion for Stay of Order of Interstate Commerce Commission pending application for certiorari—*Exxon Pipeline*

8/25/77 Flg. Response of Respondent, I.C.C., in Opposition to Motion for Stay of Order of I.C.C. pending application for certiorari—*Exxon Pipeline*

8/29/77 Flg. Memorandum of Respondent, U.S.A., in Opposition to Motion for Stay—*Exxon Pipeline*

9/ 1/77 Flg. Response of State of Alaska in Opposition to Motions of Exxon Pipeline Co. for Stay of Mandate and Stay of Order of I.C.C.—*Exxon Pipeline*

9/ 8/77 Flg. Order Denying Exxon's Motion for Stay of Mandate and Denying Exxon's Motion for Stay of ICC's order. (JRB/PHR)—*Exxon Pipeline*

9/ 8/77 Flg. Order Denying BP's Petition for Rehearing and Denying Petition for Rehearing en banc. (JRB/PHR)—*BP Pipelines*

DATE	
9/ 8/77	Judgment Issued as Mandate—*all cases*
9/26/77	Notice of Flg. of Cert. Pet. on 9-22-77—*Mobil Alaska and Exxon Pipeline*
10/17/77	Notice of Flg. of Cert. Pet. on 10-12-77—*BP Pipelines*
10/26/77	Flg. Copy of Supreme Ct. Order staying order of I.C.C. pending final disposition of petition for certiorari in Supreme Ct.—*Mobil Alaska*
11/ 1/77	Notice of Flg. of Cert. Pet. on 10-25-77—*ARCO Pipe Line*
12/ 2/77	Order of S.C. granted [certiorari] 11-28-77—*all cases*

INTERSTATE COMMERCE COMMISSION

Docket 36611

Title/Substance of Document

6/2/77 1. NOTICE: To Trans-Alaska Pipeline System owners. Requesting prompt filing of data concerning proposed rate levels and each company is asked to send a copy of its data submittal simultaneously to the State of Alaska.
[By] ROBERT L. OSWALD, Secretary (1 p.)

6/8/77 2. NOTICE: Requesting that any protests to the tariffs be filed by 6/13/77, and that replies to protests be submitted by 6/15/77.
[By] ROBERT L. OSWALD, Secretary (2 pp.)

6/13/77 3. SUPPLEMENTAL NOTICE: Advising the effective dates of tariffs filed by Sohio Pipe Line Company, BP Pipelines, Inc., and Mobil Alaska Pipeline Company have been postponed from 6/20/77 to 6/30/77, in view of these postponements, the filing dates set forth in the notice in item next above are modified, and that notice should be disregarded and requesting that protests to all of the tariffs now on file be submitted 6/15/77, and replies by 6/22/77. Parties desiring to participate in

Date

oral argument shall comply with rule 98 of the Commission's General Rules of Practice, by submitting a request for an allotment of time on or before 6/17/77.
[By] H. G. HOMME, JR., Acting Secretary (2 pp.)

6/14/77 4. PETITION: In aid of ICC Jurisdiction.
[By] STATE OF ALASKA
(by J. M. Cleary) (6 pp.)

6/15/77 5. REPLY: To the petition in item next above.
[By] SOHIO PIPE LINE COMPANY (4 pp.)

6/15/77 6. PROTEST/COMPLAINT
[By] STATE OF ALASKA
(by J. M. Cleary) (99 pp.)

6/15/77 7. PROTEST: And PETITION for Suspension and Investigation.
[By] BUREAU OF INVESTIGATIONS AND ENFORCEMENT, I.C.C.
(by E. D. Greenberg) (104 pp.)

6/15/77 8. PRELIMINARY STATEMENT
[By] TERRY F. LENZNER (representing Alaska Pipeline Commission) (267 pp.)

6/15/77 9. PETITION: AND COMPLAINT for suspension of initial rates and rules for transportation of petroleum via the Trans Alaska Pipeline System (TAPS) from Prudhoe Bay, Alaska, to Valdez, Alaska, and for an investigation thereof.
[By] ARCTIC SLOPE REGIONAL CORPORATION
(by W. W. Becker) (30 pp.)

6/15/77 10. PROTEST: And PETITION for suspension.
[By] UNITED STATES DEPARTMENT OF JUSTICE
(by P. J. Tomao) (29 pp.)

6/15/77 11. LETTER: Transmitting data, they believe, that the rate of earnings estimates will be produced by their initial tariff will not exceed any lawful criterion of the reasonableness of such earnings.
[By] SOHIO PIPE LINE COMPANY
(by J. T. Boltacz) (8 pp.)

Date

6/15/77 12. LETTER: Transmitting the basis for the computation of their tariff rate issued on 6/15/77.
[By] UNION ALASKA PIPELINE COMPANY
(by D. M. Schwartz) (4 pp.)

6/16/77 13. SUPPLEMENTAL PETITION: And COMPLAINT to the petition and complaint in item #13 above.
[By] ARCTIC SLOPE REGIONAL CORPORATION
(by W. W. Becker) (4 pp.)

6/17/77 14. ORDER: That the petition in item #4 above is *denied.*
[By] THE COMMISSION (Commissioners Murphy, Hardin, and Christian not participating) (1 p.)

6/17/77 15. ORDER: That an investigation is instituted; that the investigation in this proceeding shall include all matters and issues with respect to the lawfulness of the said schedules under the IC Act; and that the carriers parties to the schedules are made respondents to this proceeding.
[By] THE COMMISSION (Commissioners Murphy, Hardin, and Christian not participating) (2 pp.)

[Requests for oral argument time omitted]

6/17/77 21. Response to the notice in item #1 above.
[By] BP PIPELINES, INC.
(by D. A. Lucas) (23 pp.)

6/20/77 22. PROTEST: And PETITION for suspension and investigation.
[By] BUREAU OF INVESTIGATIONS AND ENFORCEMENT
(by E. D. Greenberg) (3 pp.)

6/21/77 23. LETTER: Transmitting a computation of the elements making up the determination of their proposed rate level.
[By] AMERADA HESS PIPELINE CORPORATION
(by A. S. Tabor, Jr.) (10 pp.)

6/22/77 24. NOTICE: Advising time allotments for Pipeline Companies and the protestants.
[By] H. G. HOMME, JR., Acting Secretary (2 pp.)

Date

6/22/77 25. REPLY: To the protests in item #'s 6, 7, 9, 10 and 13 above.
[By] MOBIL ALASKA PIPELINE COMPANY
(by A. J. Kilcarr) (67 pp.)

6/22/77 26. REPLY: To the protests in item #'s 6, 9 and 10 above.
[By] EXXON PIPELINE COMPANY
(by R. J. Flynn) (219 pp.)

6/22/77 27. REPLY: To the protests in item #'s 6, 7, 9 and 10 above.
[By] UNION ALASKA PIPELINE COMPANY
(by D. M. Schwartz) (25 pp.)

6/22/77 28. REPLY: To the protests in item #'s 6, 7, 9 and 10 above.
[By] PHILLIPS ALASKA PIPELINE CORPORATION
(by R. M. Shibley) (11 pp.)

6/22/77 29. REPLY: To the protests in item #'s 6, 7, 9 and 10 above.
[By] SOHIO PIPE LINE COMPANY
(by C. J. Lansdale) (34 pp.)

6/22/77 30. REPLY: To the protests in item #'s 6, 7, 9 and 10 above.
[By] AMERADA HESS PIPELINE CORPORATION
(by R. Moody, Jr.) (25 pp.)

6/23/77 31. REPLY: To the protests in item #'s 6, 7, 9 and 10 above.
[By] BP PIPELINES, INC.
(by J. Vickrey) (21 pp.)

6/23/77 32. SECOND SUPPLEMENT: To petition and complaint in item #'s 9 and 13 above.
[By] ARCTIC SLOPE REGIONAL CORPORATION
(by W. W. Becker) (8 pp.)

6/23/77 33. STATEMENT
[By] ALASKA PIPELINE SYSTEM
(by B. E. Benjamin) (13 pp.)

6/23/77 36. REPLY: To the protests in item #'s 6, 7, 9 and 10 above.
[By] ARCO PIPELINE COMPANY
(by R. E. Jordan, III) (198 pp.)

Date

6/27/77 37. LETTER: Addressed to Douglas Baldwin, requesting the Commission to reconsider its decision to close the special meeting scheduled for 6/28/77.
[By] UNITED PRESS INTERNATIONAL
(by G. Dillman) (2 pp.)

6/27/77 38. LETTER: Addressed to H. Gordon Homme, requesting. . . .
[By] DIANE B. COHN (on behalf of Edward K. DeLong, U.P.I.) (2 pp.)

6/27/77 39. LETTER: Addressed to A. Daniel O'Neal, requesting. . . .
[By] COMMON CAUSE
(by D. Cohen) (1 p.)

6/27/77 40. ORAL ARGUMENT: For testimony adduced at the oral argument held 6/27/77, see Volume 2 on page 9 herein.
[By] THE COMMISSION (208 pp.)

6/27/77 41. MOTION: For leave to file memorandum in reply to the responses of the carriers.
[By] THE DEPARTMENT OF JUSTICE
(by D. A. Kaplan) (9 pp.)

6/27/77 43. ORAL ARGUMENT EXHIBITS
[By] STATE OF ALASKA
(by J. M. Cleary) (10 pp.)

6/27/77 44. ORAL ARGUMENT EXHIBITS
[By] BUREAU OF INVESTIGATIONS AND ENFORCEMENT
(by E. D. Greenberg) (14 pp.)

6/27/77 TRANSCRIPT OF ORAL ARGUMENT: NO EXHIBITS IN EVIDENCE
(BY THE COMMISSION) (206 pp.)

7/1/77 45. THIRD SUPPLEMENTAL PETITION: And COMPLAINT.
[By] ARCTIC SLOPE REGIONAL CORPORATION
(by J. T. French) (4 pp.)

7/5/77 46. CONFERENCE: For testimony adduced at the conference held 7/5/77, see Volume 2 on page 9 herein.
(BY THE COMMISSION) (19 pp.)

Date

7/12/77 47. PROTEST/COMPLAINT: Seeking suspension and investigation.
[By] STATE OF ALASKA
(by J. M. Cleary) (10 pp.)

[End of Docket Entries in No. 36611 certified by the Secretary]

INTERSTATE COMMERCE COMMISSION

Docket I & S 9164

6/28/77 1. ORDER: That the operation of specified schedules is suspended, that the use thereof in interstate or foreign commerce be deferred from 6/30/77, and to and including 1/29/78, except as to I.C.C. 2, published by Amerada Hess, which bears a July 1 effective date and the operation of which is suspended to 1/31/78, unless ordered by this Commission; that an investigation is instituted into and concerning the lawfulness of the rates contained in the suspended schedules, as well as the interim schedules authorized to be filed, pursuant to section 15(1) and section 15(7), with a view to making such findings and orders in the premises as the facts and circumstances shall warrant; that the investigation in this proceeding shall include all matters and issues with respect to the lawfulness of the said rates under the IC Act; that the named carriers are authorized to file, upon not less than one day's notice, interim rates not exceeding specified amounts subject, however, to specified conditions; and that the said carriers are made respondents to this proceeding. (This order also embraces No. 36611).
BY THE COMMISSION (Commissioner Brown approves the order except insofar as it denied the motion of the Department of Justice for leave to file a response to the carrier's responses) (21 pp.)

7/8/77 3. PETITION: For Reconsideration.
[By] EXXON PIPELINE COMPANY
(by R. J. Flynn) (20 pp.)

Date

7/15/77 8. NOTICE: A court action was instituted on or about 7/6/77, involving these proceedings before the U.S. Court of Appeals for the Fifth Circuit.
[By] H. G. HOMME, JR., Acting Secretary (1 p.)

7/15/77 9. NOTICE: A court action . . . on or about 7/8/77. . . .

7/19/77 10. NOTICE: A court action . . . on or about 7/11/77. . . .

7/26/77 11. NOTICE: A court action . . . on or about 7/13/77. . . .

[End of Docket Entries in No. I & S 9164 certified by Secretary]

Interstate Commerce Commission Notice to TAPS Owners Requesting Tariff Data, June 2, 1977.

INTERSTATE COMMERCE COMMISSION
WASHINGTON, D.C. 20423

June 2, 1977

NOTICE TO TRANS-ALASKA PIPELINE SYSTEM OWNERS

SUBJECT: Request for prompt filing of data concerning proposed rate levels.

Tariffs for transportation of petroleum through the Trans-Alaska Pipeline System have been filed by Arco Pipe Line Company and Amerada Hess Pipeline Company, with effective dates of June 30, 1977, and July 1, 1977, respectively. Tariffs of the other six owning companies are expected to be filed shortly, in response to the Commission's request that such tariffs be filed on 30 days' notice.

In order for the Commission to make the best use of the notice period, it desires to receive the basis of computation of the proposed rate levels at the earliest possible moment. Accordingly, each owning company is requested to submit a computation of the elements making up the determination of its proposed rate level immediately or as soon as possible, without waiting for the filing of protests to its tariff. Such submittals will not prejudice in any way the companies' rights to submit replies to any protests, nor will it preclude the use of updated figures in such replies.

In addition, because of the interest of the State of Alaska in the tariff levels, each company is asked to send a copy of its data submittal simultaneously to the State of Alaska.

The companies' cooperation will help assure timely initial consideration of the tariffs, and will be greatly appreciated by the Commission.

ROBERT L. OSWALD
Secretary

Interstate Commerce Commission Supplemental Notice re Schedule for Filing of Protests and Replies, June 13, 1977.

INTERSTATE COMMERCE COMMISSION
WASHINGTON, D.C. 20423

June 13, 1977

SUPPLEMENTAL NOTICE CONCERNING FILING OF PROTESTS AND REPLIES TO INITIAL TARIFFS FOR THE TRANS-ALASKA PIPELINE SYSTEM

SUBJECT: Revised schedule for filing of protests and replies; oral argument.

The effective dates of tariffs filed by Sohio Pipe Line Company, BP Pipelines Inc., and Mobil Alaska Pipeline Company have been postponed from June 20, 1977, to June 30, 1977. In view of these postponements, and in order to allow more time for preparation of protests and replies, the filing dates set forth in the Commission's notice of June 8, 1977, are hereby modified, and that notice should be disregarded.

It is now requested that protests to all of the tariffs now on file be submitted by Wednesday, June 15, 1977, and that replies to the protests be submitted by Wednesday, June 22, 1977.

In view of the importance of this matter, the Commission has determined that oral argument should be scheduled concerning the question of suspension or investigation of the proposed tariffs. Accordingly, oral argument will be held before the Commission on Monday, June 27, 1977, commencing at 9:30 a.m.

Parties desiring to participate in oral argument shall comply with rule 98 of the Commission's General Rules of

Interstate Commerce Commission Supplemental Notice re Schedule for Filing of Protests and Replies, June 13, 1977.

Practice (49 CFR 1100.98), by submitting a request for an allotment of time on or before June 17, 1977.

This notice will be served upon each of the eight owning pipeline companies, upon the State of Alaska, upon the United States Department of Justice, and upon the Bureau of Investigation and Enforcement (ICC), and will also be posted in the Office of the Secretary, Interstate Commerce Commission, Washington, D.C., for the information of other interested persons.

H. G. HOMME, JR.
Acting Secretary

Protest of the State of Alaska for Suspension and Investigation of Initial Rates and Tariff Provisions via the Trans-Alaska Pipeline System Carriers, June 15, 1977.

[Caption Omitted in Printing]

THIS REQUIRES EXPEDITED HANDLING
BEFORE THE
INTERSTATE COMMERCE COMMISSION

I.C.C. Docket No. _____

Trans Alaska Pipeline System—Initial Rates

PROTEST OF THE STATE OF ALASKA SEEKING THE SUSPENSION AND INVESTIGATION OF INITIAL RATES AND TARIFF PROVISIONS FOR THE TRANSPORTATION OF PETROLEUM VIA THE TRANS ALASKA PIPELINE SYSTEM (TAPS) CARRIERS FROM PRUDHOE BAY, ALASKA TO VALDEZ TERMINAL, VALDEZ, ALASKA AS PUBLISHED EFFECTIVE JUNE 20, 30 AND JULY 1, 1977

Comes now the State of Alaska and files this its Protest/Complaint seeking the suspension and the institution of an immediate formal investigation of the rates and rules published by Trans Alaska Pipeline System (TAPS) carriers for the transportation of petroleum from Prudhoe Bay, Alaska to Valdez Terminal, Valdez, Alaska via TAPS. The protested initial tariffs as to which suspension is sought are shown in the following table which also shows the total annual revenues which would be generated by each company at an overall average volume of 1.2 million barrels per day.

Protest of the State of Alaska Seeking Suspension.

TABLE #1

Protested TAPS Tariff Rates and Annual Revenues

Carrier	% Ownership TAPS	Proposed Tariff	Dates Pub.	Dates Eff.	Annual Barrels (1.2 MMB/D)	Annual Rev.($)
1. Amerada Hess	1.5	$6.44	6/1	7/1	6,570,000	42,310,800
2. ARCO	21.0	6.04	5/31	6/30	91,980,000	555,559,200
3. BP	15.84	6.35	6/3	6/20*	69,379,200	440,557,920
4. Exxon	20.0	6.27	6/8	6/30	87,600,000	549,252,000
5. Mobil	5.0	6.31	6/10	6/20*	21,900.000	138,189,000
6. Phillips	1.66	-	-	-	7,270,800	-
7. Sohio	33.34	6.16	6/3	6/20*	146,029,200	899,539,870
8. Union Alaska	1.66	6.09	6/15	6/30	7,270,800	44,279,172
TOTAL	100.0				438,000,000	
SubTotal (7 pipelines)	98.34%	$6.20 avg.			430,729,200	$2,669,679,962
Projected Total	100.0%	$6.20 avg.			438,000,000	$2,714,744,724

* Postponed to June 30, 1977

The average rate published by seven carriers on 98.34% of the volume is seen to be $6.20 per barrel.

This protest seeks the suspension of these initial rates without prejudice to the filing of lower rates on one day notice pursuant to Special Permission of the Commission, which lower rates would be consistent with the standards of reasonableness urged herein and which would be consistent with the stated grounds on which the Commission believes that the initial tariffs would, if permitted to become effective, result in rates and charges which would be un-

just and unreasonable in violation of Section 1(5), unjustly discriminatory in violation of Section 2 and unduly preferential and prejudicial in violation of Section 3(1) of the Interstate Commerce Act and constitute a destructive competitive practice and otherwise operate in contravention of the National Transportation Policy.

The State of Alaska, consistent with the position espoused in this protest regarding the need for a suspension and the standards which should be applicable to a determination of the maximum rates which should be permitted to become effective, subject to continuing investigation and refund provision, would not object to tariffs being filed on one day notice not exceeding the following:

Carrier	Published Rate	Maximum Interim Rate*
1. Amerada Hess	$6.44	—
2. ARCO	6.04	$3.74
3. BP	6.35	4.42
4. Exxon	6.27	3.80
5. Mobil	6.31	3.59
6. Phillips	—	—
7. Sohio	6.16	4.04
8. Union Alaska	6.09	3.85

* Subject to refund provisions and continuing investigation.

This position stated in this Protest does not waive the rights of the State of Alaska to have the Commission ultimately determine a lower level of just and reasonable charges from the initial effective date. The State of Alaska does not waive its rights to pursue all arguments challenging the lawfulness of the initial tariffs. The purpose of this protest/complaint is to obtain the suspension of those

tariffs to the extent that they clearly exceed a maximum reasonable level. Maximum reasonable revenues for the TAPS carriers can encompass no more than a recovery of reasonable and prudent operating expenses, including reasonable depreciation charges and Alaska Pipeline taxes, plus reasonable interest expenses of the pipeline, a reasonable accrual for "removal costs", and a reasonable return on the equity shareholders' proportionate share of the reasonable and prudent investment dedicated to public service.

SUMMARY OF ARGUMENT

The initial TAPS tariffs permitted to become effective should not be one penny higher than absolutely necessary. The Interstate Commerce Commission is under a clear Congressional mandate, pursuant to the National Transportation Policy[1] and the Rule of Ratemaking[2] to promote safe, adequate, economical and efficient service and foster sound, economic conditions in transportation, to encourage the establishment and maintenance of reasonable charges for transportation services, without unjust discrimination, undue preferences or advantages or unfair or destructive competitive practices all to the end of developing, coordinating, and preserving a national transportation system adequate to meet the needs of the commerce of the United States. Under the Rule of Ratemaking the Commission is specifically required to give due consideration to the effect of rates on the movement of traffic and to the need in the public interest of adequate and efficient transportation service at the lowest cost consistent with the furnishing of such services. In analyzing the needs of the TAPS carriers for revenues such determinations must be made

1. 49 U.S.C., preceding Section 1
2. 49 U.S.C. § 15a(2)

in consideration of "honest, economical and efficient management". The foregoing standards are to guide and control the Commission's deliberations in determining what should be the just and reasonable rates to permit to become effective for the transportation of petroleum via the TransAlaska Pipeline System.

1. *Construction Costs*

The construction costs for TAPS constitute the first area in which there is a grave obligation upon the Commission to see that no tariffs are premised on other than expenditures required to provide the service at the lowest cost under honest, economical and efficient management. The Commission is to be commended for undertaking its own fiscal and management audit of the TAPS construction expenditures.[1] On November 22, 1976, the Alaska Pipeline Commission initiated an investigation into the costs associated with the design and construction of the TransAlaska Pipeline System. The Alaska Pipeline Commission (APC) has a twofold interest and responsibility with respect to the costs of construction and design of TAPS: first, the Commission regulates the tariff charge for the intrastate transportation of oil in the TAPS system; and second, the Alaska Pipeline Commission is statutorily required to assist the Attorney General of the State of Alaska in intervening on behalf of the State of Alaska in any Interstate Commerce Commission proceedings regarding the interstate tariff charged by the TAPS carriers. To conduct an investigation into the design and construction expenditures for the TAPS system the APC retained Terry F. Lenzner as its Special Counsel in conducting the investi-

1. Contract ICC 76-10 with Touche Ross & Co. and letter contract I.C.C.-L-771.

gation and also retained the services of several independent consultants[1] to assist the special counsel. A summary of the results of that investigation to date entitled "Preliminary Statement of Terry F. Lenzner", accompanies this protest as supporting documentation for this serious challenge made by Alaska regarding the allowable nature of the overall TAPS' claimed expenditures for construction costs.

Despite obstacles and constraints placed by Alyeska and the owning TAPS carriers in the path of the investigation conducted by the Special Counsel, as described by the Special Counsel in his statement, the evidence obtained, in the Special Counsel's view,

> "reveals a project characterized by an unnecessary duplication of management structure and responsibility, ineffective utilization of labor and equipment, an inexcusable absence of effective cost control procedures and incentives or other evidence of concern about excessive costs, a refusal to authorize adequate planning and design prior to construction, and an

1. The independent consultants assisting Mr. Lenzner are:
   1. Dr. Robert Lind: Professor, Graduate School of Business and Public Administration and Director, Energy Policy Studies Unit, Cornell University; Ithaca, New York.
   2. *Aerospace Corporation:* Engineering and Economic consultants with extensive experience in Alaskan transportation, energy, and environmental matters; Los Angeles, California.
   3. *VHS Associates:* Consultants in cost estimating and construction management of pipelines, terminals, and comparable facilities; San Rafael, California.
   4. *Resource Planning Associates:* Economic and management consultants with extensive experience in issues relating to the oil and gas industry; Cambridge, Massachusetts.

> inexplicable failure to establish information and cost control systems essential for an efficient construction effort."

The TAPS construction project has been plagued by monumental cost overruns. Originally to cost less than $900,000,000, the final construction cost estimate escalated to $4 billion in early 1974, to $6.4 billion in 1975 and to today's projection of $8 billion (without capitalized interest costs). As stated by Mr. Lenzner:

> "While some of the ten-fold increase can be attributed to factors beyond the control of the TAPS owner companies and their agents, it seems clear that hundreds of millions of dollars were wasted as a result of mis-management and an organizational lack of concern about economy or efficiency." (Lenzner, pp. 4-5)

As this Protest is being prepared, the Special Counsel and his associates are still continuing to develop the documentation in support of these conclusions. In providing specific documentation in support of the conclusions certain caveats are to be kept in mind as pointed out by Mr. Lenzner:

> "First, because a 'cost-plus' mentality appears to have pervaded nearly every aspect of the project, many excessive costs were incurred in a manner rendering them difficult to verify or to quantify . . . Second, while it is necessary to categorize the evidence, a construction project consists of many parts which are intricately inter-related. Thus every im-

1. Preliminary Statement of Terry F. Lenzner, Special Counsel, Alaska Pipeline Commission, p. 4, hereinafter Lenzner.

> prudent decision had not only a primary impact upon project costs, but also numerous 'ripple' effects beyond a given cost category which each contributed to the sum of excessive expenditures." (Lenzner, p. 5)

Mr. Lenzner's statement provides more detail regarding the excessive costs resulting from a general failure to meet the mandate for "honest, economical and efficient management." This evidence derived by the special investigation is categorized in the following areas: (1) Overall TAPS organization and structure; (2) Internal Controls; (3) Construction equipment, spare parts and inventory control; (4) Labor productivity; (5) Support services; (6) Above-ground design and construction; (7) Welding; (8) River crossings; (9) Section 5; (10) Valdez terminal.

Alaska submits that the results of a complete investigation by the Interstate Commerce Commission will fully support an ultimate conclusion, based on the record, that there were excessive costs incurred resulting from the problems outlined in the summary of the Lenzner investigation to date. Alaska submits that the result of the complete investigation will disclose and quantify *hundreds of millions of dollars* that were expended in a fashion that cannot be described as a prudent investment in used and useful carrier property. Nor can such expenditures be described as having been made under "honest, economical or efficient management."

Alaska believes that the ultimate investigation will justify the disallowance of hundreds of millions of dollars of expenditures claimed by TAPS' owners and their agent, Alyeska Pipeline Service Company (Alyeska). Alaska urges the Commission to take into account the facts and analysis contained in the Lenzner Report to disallow, pending completion of a full investigation, a substantial portion

of the costs upon which the carriers have based their tariffs. For purposes of analysis, all the calculations the State presented in this protest assume that the expenditures and projected operating expenses claimed by the carriers[1] will be allowed. One possible exception to the rule that this protest by the State of Alaska has generally accepted as valid and accurate, for purposes of analysis, the numbers submitted by the pipelines, is the figure for annual expenses alleged to be incurred for removal costs based on an estimate by Alyeska of $1.049 billion in 1977 dollars for removal cost at retirement date.[2]

2. *Interest During Construction*

As part of the claimed original cost of TAPS, the pipelines are claiming an allowance for the capitalization of interest during construction. The apparent estimates of the amount of capitalized interest during construction vary considerably. There had been general references forthcoming from Alyeska that interest during construction would be approximately $1.3 billion. No documentation

1. Letters from the various pipelines to the I.C.C. responsive to the I.C.C. request dated May 11, 1977 as follows: (1) Amerada Hess Corporation, June 1, 1977, signed by R. K. Stafford, Senior Vice President; (2) ARCO Pipeline Company, June 1, 1977, signed by J. D. Wessling, Comptroller-Treasurer and Manager-Administration & Control; (3) BP Pipelines, Inc., May 27, 1977, signed by P. H. Jones; (4) Exxon Pipeline Company, June 1, 1977, signed by J. D. Sturtevant, Controller; (5) Mobil Alaska Pipeline Company, May 27, 1977, signed by C. R. Thompson, Controller-Treasurer; (6) Phillips Petroleum Company—estimates, unsigned two pages; (7) Union Alaska Pipeline Company, May 27, 1977, signed by E. J. Takach, Controller; and, finally, (8) Sohio Pipeline Company, June 10, 1977, telephone communication to I.C.C.

2. See letters cited in immediately proceeding footnote.

has ever been provided to substantiate this number.[1] Based on an expansion of the individual depreciation expenses for 1978 claimed by the various TAPS carriers, which expense include amortization of the interest during construction, the claimed interest during construction varies substantially. However, the highest claimed total TAPS cost, including capitalized interest during construction, of $9,590,000,000 (based upon Amerada Hess' expansion of its claimed individual depreciation and amortization cost of $5,754,000 for its 1.5% interest) indicates total interest during construction of $1.618 billion, which appears to be substantially overstated. The average interest during construction, even accepting the realiability of the carrier figures, would indicate a figure of approximately $1.2 billion, rather than the $1.3 billion referred to by Alyeska.

3. *Operating Expenses Other Than Depreciation and Amortization.*

Operating expenses other than depreciation claimed by the TAPS owners do appear to be highly questionable as to the accuracy and reasonable nature of the amount claimed under honest, economical and efficient management particularly in the areas of: (1) Outside services which account for approximately 50 percent of the expenses incurred by Alyeska (Accounts 320, 420 and 520); (2) Expenditures for operating fuel and power (Account 330) by Alyeska as well as the additional amounts reported as being incurred directly by the individual pipelines, particularly in view of the question as to the possible sources of such fuel and power and the prices at which it would be

1. At the "Sunshine Act" Conference of the Commission on May 3, 1977, an apparently incorrect number provided by Touche Ross of $2.3 billion for interest during construction was referred to. This was subsequently conceded to be incorrect.

purchased from such sources; and (3) The general lack of documentation and support by way of explanation for any of the claimed amounts attributed to specific accounts. In sum, the operating expenses other than depreciation are certainly the proper subject for serious question as to the necessary amount under honest, economical and efficient management. However, the total operating expenses, incurred by both Alyeska and the individual pipelines for other than depreciation accounts for approximately *90 cents per barrel* in the total cost of transportation.

4. *Depreciation And Amortization Expenses*

Depreciation and amortization expenses are significantly overstated as a result of the interaction of two factors: (1) the inclusion in the depreciation base of all expenditures including those which are excessive and which should ultimately be disallowed; and (2) the use of a depreciation life substantially shorter than would be permissible under presently outstanding orders of this Commission applicable to individual TAPS carriers or under the known facts. The TAPS carriers are using 25 years whereas a life of 35 years or more would be normal. The shift from 35 to 25 years increases the depreciation expenses by approximately 40 percent or approximately 23 cents per barrel based upon the different depreciation bases apparently used by the separate TAPS carriers. By using a short 25 year life, depreciation and amortization expenses claimed by the TAPS carriers, which "expenses" represent non-cash items, amount for approximately 84-85 cents per barrel at 1.2 MMB/D. These expenses should be reduced by 23 cents per barrel to reflect a more realistic 35 year life.

5. *Interest Expenses.*

Because the rate base is inflated by excessive costs which may be disallowed under the prudent investment standard mandated by the requirement for honest, economical and efficient management, claimed interest expenses in connection with debt incurred to make those TAPS expenditures are likewise and equally overstated. The total of the interest expenses claimed by the TAPS owners for a one-year period is $695,052,000 or 158.69 cents per barrel at an average throughput of 1.2 million barrels per day.

The total of all claimed expenses incurred by the TAPS owners only amounts to approximately $3.44 per barrel. A $3.44 per barrel rate figures on an average daily throughput of 1.2 MMB/D will cover: (1) total "operating expenses" of 175.93 cents per barrel, including the non-cash allowance for depreciation and amortization amounting to 83.28 cents per barrel over the shortened 25 year life of a pipeline with a claimed $9.275 billion cost; (2) removal costs of 9.58 cents per barrel; and (3) interest expenses of 158.69 cents per barrel.

There is still a quantum leap from the pipelines' coverage of all expenses, including depreciation, removal costs and interest totalling only $3.44 per barrel to the tariffs which they have published which exceed $6.00 per barrel. As indicated above, the weighted average rate for the seven pipelines accounting for 98.34% of the total volume is $6.20 per barrel. The difference between $6.20 per barrel and the total of $3.44 per barrel covering all expenses, cannot be and is not justified by the demand for "profit" or a return to the stockholders the oil companies.

Every penny over the reasonable allowance to stockholders for a fair return on those stockholders' actual investment constitutes a discrimination, if not a rebate, to

them as shippers who are being preferred to the prejudice of non-owning shippers in violation of Sections 2 and 3(1) of the Interstate Commerce Act.

Perhaps the most significant effect of a TAPS rate that a rate even one cent higher than absolutely necessary operates to exclude would be competitors of TAPS owners and, most significantly, a higher than necessary TAPS rate, will result in costs which "will not be affordable by some future energy projects with the result that some known energy sources will not be developed."•

In view of the serious doubts as to whether the construction expenditures as well as claimed operating expenditures and other expenses projected for a years' operation are valid under the standard of providing transportation service at the lowest cost consistent with honest, economical and efficient management, the stockholders, who stand in the place of the pipeline management, shall not be entitled to rewards beyond a minimum return on their actual investment. Average and high returns are merited only by management which can demonstrate that it is deserving of additional incentives and rewards as a result of proven efficiency.

In addition, any analysis of the comparable risk involved in the financing and recovery of an investment in a pipeline such as TAPS which is in a totally dominant monopoly position and is the only means of transporting billions of barrels of necessary oil reserves from Alaska, would show that such risks are minimal. The risks of the pipeline, which was only built after there were known reserves and a known market, are not the risks of an oil company exploring for oil. The pipeline is only constructed after the exploration has been completed and there are proven "recoverable reserves". Under these circumstances it would be unconscionable for the Commission to permit the pipe-

lines to earn a return on the equity portion of the investment and thereby reward management and the stockholders (the oil company owners) with more than a minimum return commensurate with the efficiency and economy of the management in being able to meet the requirement for transportation service at the lowest possible cost.

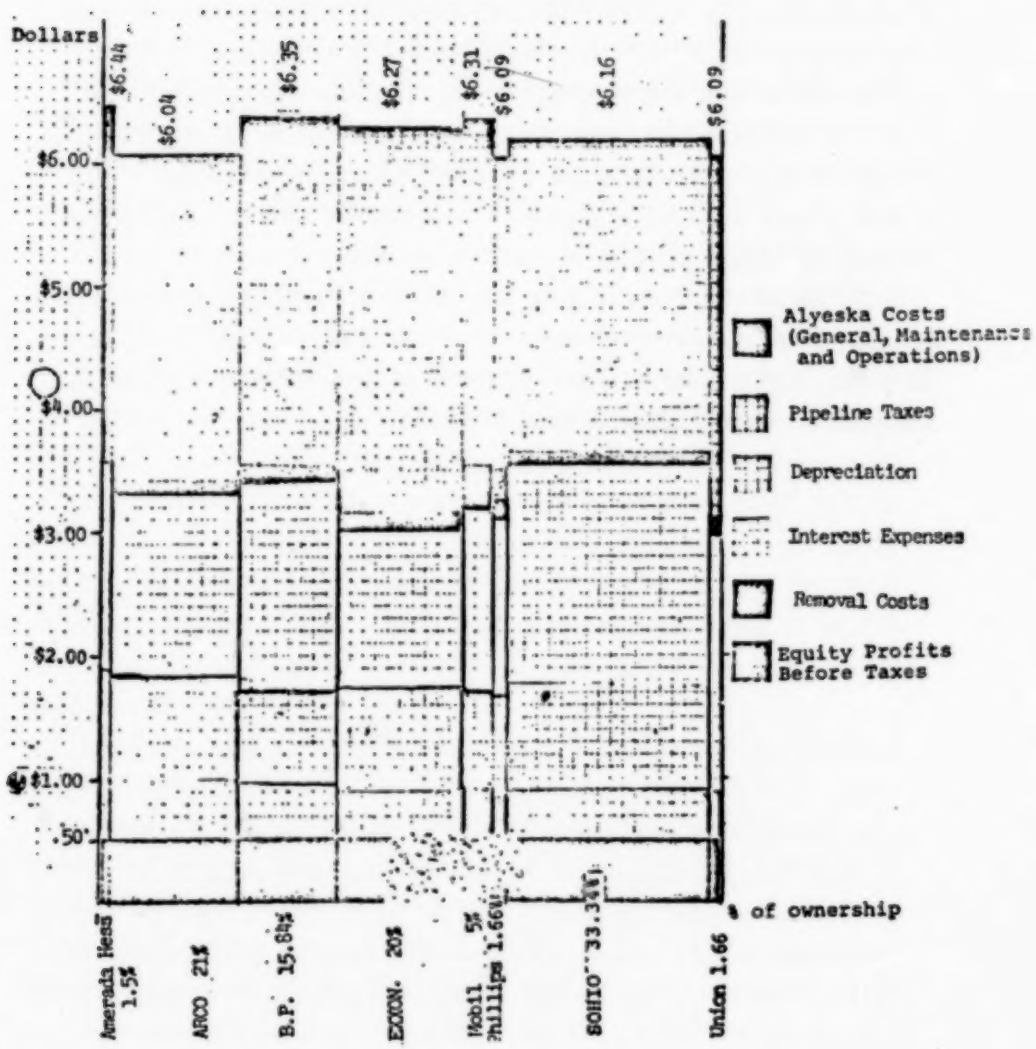
The following page graphically depicts the elements of the TAPS tariffs in cents per barrel based on the carriers' submission summarized in Appendices A & B, hereto. The graph alone indicates there is too much "green" going to the oil company equity owners of TAPS.

A $6.20 average rate per barrel will result in excessive profits. Initial rates should be permitted to become effective no higher than those shown in the table at page 4, subject to investigation and refund.

Protest of the State of Alaska Seeking Suspension.

PROTESTED TAPS RATES

A Breakdown Analysis of
Costs and Profits Per Barrel



Protest of the State of Alaska Seeking Suspension.

ARGUMENT

I. *The Commission's Power to Suspend Initial Rates*

• • •

II. *Development of Vital Energy Sources Requires Suspension of the Protested TAPS Tariffs*

Perhaps the most important aspect of this case is its impact upon the development of future energy sources, as well as other development, in the area tributary to and potentially served by TAPS. The economic potential and viability in the development of energy sources on the North Slope of Alaska is directly related to the level of the TAPS tariff. For development to be economically feasible the return to the producer must include not only the production costs but also the transportation costs to the ultimate market so that the price at that market is competitive. To the extent that the TAPS rate is even one cent higher than absolutely necessary to meet the standards of the National Transportation Policy and the rule of rate making that rates must promote safe, adequate, economical and efficient service and sound economical conditions in transportation, further development of Alaska's vast oil resources will be discouraged and possibly prevented.[1]

It is obvious that the costs reasonably incurred by way of prudent expenditure in the construction and operation of TAPS can and should be borne by the rates paid for the transportation of oil from Alaska's North Slope. But it is only such reasonable and prudent expenditures consistent with honest, economical and efficient management which should be included within the transportation charge be-

1. See 45-50 *infra.* relative to depreciation where the amount of potentially recoverable oil resources in Alaska is discussed.

cause the cost of transportation must ultimately be borne by the consumer in the form of higher energy costs. In addition, excessive transportation costs will deter the development of needed energy resources. These points were recently made with some eloquence by Mr. E. L. Patton, Chairman and Chief Executive Officer, Alyeska Pipeline Service Company, to the Town Hall of California, in Los Angeles, California where he stated on May 17, 1977:

> "Obviously, the costs of these things [pipeline construction costs including environmental related expenditures] must ultimately be borne by the consumer in the form of higher energy costs. What is not so obvious is that the requirements will not be affordable by some future energy projects *with the result that some known energy sources will not be developed,* and all projects will have longer lead times and longer construction schedules." (Emphasis added.)

Mr. Patton's statement regarding the impact of costs related to environmental and other factors is equally applicable to the impact of transportation rates above the level absolutely necessary to provide service at the lowest cost under honest, economical, and efficient management.

The eight oil pipelines which are the owners of TAPS are owned by vertically integrated companies and they will use their individual TAPS interest to ship their own crude oil plus whatever other oil will be tendered by non-owning shippers or by owner-shippers producing in excess of their pipeline capacity. Clearly, excessive transportation rates will deter development of energy resources by producers other than the TAPS owners. However, even if almost all shipments are made by owners of the pipelines, aggressive and effective rate regulation is still absolutely necessary since excessively high rates would discourage maximum efficient use of the line even by owner-shippers and thus would inhibit development of the oil resources in Alaska.

As recently stated by the Justice Department in its submission to this Commission in Ex Parte 308, *Valuation of Common Carrier Pipelines,* under date of May 27, 1977:

> ". . . First, as excess earnings are the result of a rate structure which yields returns beyond what is reasonably necessary to attract capital, we must assume that the actual tariffs charged do not encourage the maximum efficient use of pipelines. Consequently, the amount of oil reaching final markets is artificially restricted and its price is necessarily too high. . . ." (Page 27)
>
> ". . . Important goals of regulation are to encourage greater output than the firm would produce if unregulated and to ensure that the costs savings derived from economics of scale accrue ultimately to the consuming public in the form of lower prices. The tariff rate level of a regulated pipeline which will just cover all costs including the cost of capital should be lower than the level an unregulated firm would set in order to maximize its profits. Since the demand for pipeline services will be greater at a lower tariff rate, proper regulation will result in a greater output than no regulation. . . ." (Pages 49-50)
>
> ". . . Consequently, pipeline rate bases are inflated and tariff rates are significantly above the level necessary to allow owners a reasonable return on investment. The result is to reduce the amount of

> petroleum carried by way of this most efficient mode of transportation to the detriment of national energy objectives." (Page 61)

Unless the Commission suspends the protested tariffs and only permits rates to become effective at the lowest cost consistent with the provision of honest economic and efficient service, any higher rate level will be detrimental of the national energy objective of encouraging the maximum production of domestic oil, including the North Slope of Alaska. The high tariff will make it economically less feasible or perhaps non-feasible for other than the owners of the pipeline to develop petroleum resources on the North Slope. Higher than necessary tariffs will, *de facto*, operate to create an exclusive club of those who can afford to develop the North Slope, that club being comprised of those oil companies who own the TAPS carriers. High TAPS tariffs will deny the nation the benefit of competitive development of our energy resources contrary to the goal of Congress as indicated in the legislative history of the Trans-Alaska Pipeline Authorization Act, P.L. 93-153.[1]

To stimulate the maximum production and development of our natural resources on the North Slope of Alaska, the TAPS tariffs must be held to lowest cost consistent with the provision of service as mandated by Congress.

III. *The Protested Tariffs are in Violation of the Commission's Criteria for Total Pipeline Fair Earnings.*

Apparently the primary reason as to why the TAPS tariffs are so excessively high (in addition to the fact that construction costs and the related interest during construc-

1. See Senate Report No. 93-207, June 12, 1973.

tion expenses are excessive and an unreasonably short service life is assumed for depreciation and amortization purposes) is that the pipelines are simply and boldly asking to be paid twice for a return on the investment. The carriers would like the public and the Commission to believe that they are only asking for a very low "return on investment". For example, in the *Washington Star* on Wednesday, June 1, 1977, under a front page headline stating "That Alaska 'Cheap Oil' Price Tag Goes Up", where the issuance of the first TAPS tariff by Arco at $6.04 per/barrel was reported, there is the following statement:

> "An ARCO official said the transportation cost is calculated to yield the owners of the pipeline—the parent oil companies—a return on their investment of 7 percent. He pointed out that the I.C.C. has approved an 8 percent-return on other crude oil pipelines and 10 percent on pipelines that carry petroleum products."

To properly understand the mentality of the pipelines in publishing the high rates as evidenced in their TAPS publications it is necessary to penetrate the meaning of the words "their investment" and contrast the pipeline's meaning with any normal regulatory sense of the concept of "capital invested" in used and useful property. While it is true that the pipelines as such may be able to claim that they have spent money and therefore "invested" in excess of $9 billion in the construction, including interest during construction, of TAPS, the source of the investment capital dollars have been two-fold: (1) debt and (2) equity. In the case of TAPS, it has generally been estimated that of the total cost of construction approximately 85 percent was debt financed with only the balance being provided through

equity investment. Stated differently, out of every $100 actually invested in the construction cost, $85 was provided by lenders in the form of debt and $15 was provided by equity shareholders (the parent oil companies) in the form of equity investment. Yet the pipelines, as indicated by the above statement attributed to the Arco official,[1] apparently designed their rates to provide a return to the equity owners in a dollar amount equivalent to 7 percent of the *total* investment, not 7 percent on "their [the parent oil company's equity] investment."

Simply stated, a rate structure that provides a return to the equity owners equivalent to 7 percent of the total capital invested when in fact the equity investment is only 15 percent of the total capital results, *de facto,* is a return to *equity* of 46.7 percent (7 divided by 15). It is inconceivable that the pipelines could really believe that the Interstate Commerce Commission would permit such returns as just and reasonable.

Administrative Law Judge Joseph L. Nacy in Docket 36244, *Charge for Terminalling and Storage, Kenai Pipe Line,* clearly rejected a pipeline argument that the consent judgment of the District Court of the United States for the District of Columbia, entered December 23, 1941, in that court's Civil Action No. 14060, *United States of America* v. *Atlantic Refining Company, et al,* allows a pipeline after tax earnings to the equity owner of up to 7 percent of valuation stating:

> "KPL has laid stress on the above-cited District Court case as authority for its being permitted to earn 7 percent above valuation, while APC dismisses the case as being no authority. My reading of the copy of the judgment attached to APC's verified submission leads me to agree with protestant. The judgment attempts only to set a limit upon the amount of *dividends* which may be paid by pipeline companies to their shipper-owners. It goes no farther than this, and is not authority for limiting or expanding the amount of *earnings* any pipeline company may enjoy."[1]

1. Cf. June 14, 1977 letter to I.C.C. from Union Alaska Pipeline Company using "Maximum Allowable 7% Consent Decree Net Income" for equity only.

The carriers are clearly incorrect when they assume that the Commission will grant them rates which will provide the equity holders of the pipeline a "return on investment" (profit to the equity holder, after taxes) computed by applying a rate (either the 7 percent mentioned in the Consent Decree, the 8 percent used by the Commission for its criteria for pipelines, or some other alleged cost of capital or rate of return) against a base reflecting either the total capital invested in the carrier property or even a "valuation" which exceeds the amount of total capital actually invested in the carrier property. Yet it is obvious that the TAPS carriers are operating upon the basis of such a mistaken belief or gross misunderstanding of the Commission's interpretation of "just and reasonable" when they seek to extract rates in excess of $6.00 per barrel to transport oil from Prudhoe Bay to Valdez.

The obvious misinterpretation or misunderstanding of the proper regulatory criteria is apparent upon review of the submission dated June 13, 1977 from Sohio Pipe Line

1. By order of the Commission, Division 2 (Commissioners Hardin, O'Neal and Christian), dated October 19, 1976, served October 21, 1976 the Commission allowed the withdrawal of the protest of the Alaska Pipeline Commission and discontinued the proceedings in light of the statement of position of the Alaska Pipeline Commission which had been submitted in lieu of exceptions.

Company to the Interstate Commerce Commission over the signature of J. T. Boltacz, Vice President, Sohio Pipe Line Company. This letter was received by the undersigned counsel for the state of Alaska at 2:45 p.m. on Tuesday, June 14, 1977, the day before this protest was due to be filed pursuant to the request of the Interstate Commerce Commission. A review of that submission, particularly Schedule I thereto, reveals that Sohio calculates its "accumulative rate of return %" as a percentage of the "valuation" but after deducting ad valorem taxes, operating expenses other than depreciation and ad valorem taxes, depreciation, *interest expense*, and "statutory income taxes".

The pipelines are blatantly asking that they be paid twice for the return on that portion of the investment in the carrier property which was provided by debt capital: first in the form of interest expenses and second in the form of a "return on investment" calculated against the total cost of the carrier property, which includes debt as well as equity securities. The most polite term that could be applied to this process is "double-dipping", with all of its connotations. In the vernacular it might be referred to as a colossal "rip off." If, in fact, the pipelines believe what they say when they claim that they are only following "the methods traditionally utilized in testing the effect and fairness of common carrier pipeline rates"[1] then there is great reason for concern that the excessive profits which also permeate the TAPS tariffs may also permeate other oil pipeline rates.

Whether or not the deduction of interest before calculating a return on the total capital can accurately be characterized as "the methods traditionally utilized" in calculating pipeline rates,[1] the traditional methodology which was allegedly utilized by the pipeline companies in establishing their tariffs has resulted in excess profits to the pipeline companies. In this context, it is appropriate to note the *conclusions* reached by the immediate past Attorney General of the United States, Edward H. Levi, when reporting to Secretary of Transportation, William T. Coleman, pursuant to Section 7 of the Deep Water Port Act of 1974 (33 U.S.C. §1506), on the possible anticompetitive impact of licensing Loop, Inc. and Seadock, Inc. as ports off the coast of Texas. That report, dated November 5, 1976 states:

> "While I.C.C. regulation prevents firms from exploiting this natural monopoly to the fullest extent, it probably allows some excess profits to be earned." (page 56)
>
> • • •
>
> "Our analysis indicates that I.C.C. regulations is far from perfect and will result in a tariff which yields profits in excess of the required return to capital." (page 61)

Even though the "methods traditionally utilized" have resulted in excess profits to the oil pipeline companies, as noted above, an analysis of the Sohio tariff indicates that the Sohio rate calculations are based upon an incorrect interpretation of the "methods traditionally utilized" by the Commission. The Sohio rate calculations result in a return even greater than permitted by Commission precedent. It is therefore necessary to discuss the "methods traditionally utilized" by the Commission and the manner in which the Sohio rate calculations deviate from precedent.

1. Sohio Pipe Line Company letter of June 13, 1977 to the I.C.C., p. 2; Cf. Union Alaska Pipeline Company, June 14, 1977 letter.

1. This issue is further discussed *infra*, at pp. 35-36.

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Pipelines are extremely important in the transportation system of this country. In 1975, 104 pipelines subject to ICC regulation accounted for the transportation of 488 trillion ton-miles or 23.51% of the total of all modes in that year.[1] Pipeline transport crude oil, petroleum products such as gasoline, kerosene, jet fuel, fuel oils, LPG, as well as, more recently, liquid fertilizers (principally anhydrous ammonia) and coal via coal slurry pipelines. Despite this great importance of transportation via pipeline and the fact that the ICC has had jurisdiction over pipelines since 1906 with the passage of the Hepburn Act, there are relatively few cases dealing with pipeline rate regulation.

The Commission has considered the reasonableness of pipeline rates in basically four case: *Reduced Pipe Line Rates and Gathering Charges,* 342 I.C.C. 115 (1940), *Petroleum Rail Shippers' Assn.* v. *Alton & S.R.,* 243 I.C.C. 589 (1941); *Minnelusa Oil Corp.* v. *Continental Pipe Line Co.,* 258 I.C.C. 41 (1944), and *Petroleum Products, Williams Brothers Pipe Line Company,* 351 I.C.C. 102 (1975) affirmed on reconsideration, —— I.C.C. —— (Docket 35533 et al., served December 21, 1976).[2] This last decision in Docket 35533, et al., is the subject of a petition for judicial review.[3] There is a related case involving a subsequent increase by the same pipelines, Williams Pipe Line Company

1. 90th Annual Report of the ICC, Appendix E, Table 3, page 142.

2. On March 4, 1977 in I&S No. 9128, *Anhydrous Ammonia, Gulf Central Pipeline Company,* (Unprinted, Review Board No. 4) a Review Board found a proposed 10 percent general increase shown to be just and reasonable based on the 10 percent return in valuation criteria.

3. *Farmers Union Central Exchange et al* v. *I.C.C. and U.S.,* No. 76-2138, United States Court of Appeals for the District of Columbia, filed December 21, 1976

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and Explorer Pipeline Company, which is presently pending before the Commission.[1]

In each of those decisions the Commission's valuation of the carriers' properties, rather than the original cost less accrued depreciation or net investment, was used as the rate base in judging the reasonableness of the carrier's rates. Rates of return of 8 percent on valuation for crude oil pipelines and 10 percent on valuation for petroleum products pipelines were determined to be reasonable in the *Reduced Pipe Lines Rates, Minnelusa,* and *Petroleum Rail Shippers,* cases, *supra* and still followed in the recent *Williams* cases, *supra.* In *Williams,* the Commission stated that "until the principles underlying the determination of a fair rate of return for pipelines can be formulated in a proper proceeding, it would be unwarranted for us to hold that a rate of return which was considered reasonable in 1941 is excessive today." (Docket 35533, December 3, 1976, p. 11). The Commission has further indicated that the appropriate proceeding for consideration of possible modification of its valuation rate base methodology as well as the proper rate of return for pipelines is Ex Parte 308, *Valuation of Common Carrier Pipelines,* a proceeding started in 1974 and in which the *opening* statements were submitted April 27, 1977 and reply statements were submitted May 27, 1977 with a hearing now scheduled for August 16, 1977. *See* 351 I.C.C. 102, 106, 112, 126 (1975).

The Sohio rate calculations determine the rate of return *after* deduction of interest. However, in each of the Commission proceedings where it has dealt with the question of a fair return to pipelines, the determination that an annual return of more than 8 percent on value would be in excess

1. I&S 9089, *General Increase, December 1975, Williams Pipeline Company,* pending on exceptions to the Initial Decision of Administrative Law Judge, Earl S. Dowell, served July 27, 1976.

of a fair return was calculated *before* deduction of any interest expense.

The presently controlling precedents, *Reduced Pipeline Rates and Gathering Charges,* 243 I.C.C. 115 (1940); *Minnelusa Oil Corp.* v. *Continental Pipeline Co.,* 258 I.C.C. 41 (1944); and *Petroleum Products, Williams Brothers Pipeline Company,* —I.C.C.— (December 21, 1976, not printed), affirming 351 I.C.C. 102 (October 1975), clearly indicate that it is not the I.C.C. methodology to deduct interest expenses before calculating an overall allowed rate of return.

In I.C.C. Docket No. 36244, *Charge for Terminalling and Storage, Kenai Pipe Line,* Administrative Law Judge Joseph R. Nacy in an initial decision served July 20, 1976 concluded:

> ". . . . That interest should not be included as an expense item for the purpose of the present proceeding. However, the rate of return is expected to cover serving of debt."

In other words, under Commission precedent the 8 percent on valuation is to encompass and include the coverage of interest payments within the balance remaining for equity.

As noted above, as recently, as December 3, 1976 the Commission [Vice Chairman Clapp and Commissioner Christian not participating, Commissioner (now chairman O'Neal), dissenting] stated that "considerations of consistency and fairness require that we adhere to our previously recognized criteria in investigating the rates of particular pipelines at the present time." Docket No. 35533, *Petroleum Products, Williams Brothers Pipe Line Company,* —I.C.C.— (Decided December 3, 1976, served December 21,

1976, not printed, page 8), affirming 351 I.C.C. 102 (1975). At page 16 of the December 3, 1976 Report of the Commission on Reconsideration in the *Williams* case the Commission again explicitly set forth its method of computing a "return on valuation" for the purpose of testing the return against its criteria. The criteria in the *Williams* case, since Williams was considered a product line, resulted in return on valuation of 10 percent.

The following table sets forth a comparable computation, based upon the Commission's methodology, of the "return on valuation" for Sohio Pipe Line Company utilizing the information made available by Sohio in the afternoon of Tuesday, June 14, 1976.

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TABLE

Calculations Of TAPS Profits And Expenses Based On Sohio Pipe Line Company Estimates

		Amount	Cents Per Barrel
1.	Tariff	$6.16	616.00
2.	Shipments Million Barrels Per Year	- 146 -	
		(Millions of Dollars)	
3.	Valuation	$3315.0	
4.	Operating Revenue	899.4	616.00¢
5.	Operating Expenses:		
	a. Ad Valorem Taxes	51.0	34.93¢
	b. Operating Expenses	98.2	67.27¢
	c. Depreciation	126.2	86.44¢
	d. Total "Operating Expenses"	275.4	188.36¢
6.	Net Carrier Operating Income	624.0	427.40
7.	Interest	252.5	172.94
8.	Ordinary Income Before Taxes	371.5	254.45
9.	Statutory Income Taxes:	196.5	134.38
	a. Alaska (9.4%)	34.9	23.90
	b. Federal (48%)	161.6	110.68
10.	Net Income	175.0	119.86
11.	Equity	444.0	—
12.	Rate of Return On Equity After Taxes	39.4%	
13.	Rate of Return On Valuation Before Taxes (Line 6÷ Line 3)	18.8%	
14.	Rate of Return on Valuation After Taxes (Line 6-Line 9 ÷ Line 3)	12.9%	

Source: Sohio Pipe Line Company letter to I.C.C. dated June 13, 1977 and accompanying Schedules.

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The foregoing Table of Calculations of TAPS profits and expenses based on Sohio Pipe Line Company estimates made available on June 14, 1977 proves that the rate of $6.16 as published by Sohio is clearly unjust and unreasonable. Assuming, *arguendo,* the propriety of imputing statutory income taxes, even though it is known that Sohio will be able to defer the payment of federal income taxes as a result of accelerated depreciation and will receive investment tax credits of substantial amounts resulting from their investment, the rate of return after imputed taxes on shareholder equity will be 39.4 percent! (Shareholder equity is admitted by Sohio to be only $444.0 million, Sohio's Schedule V). We submit that any "regulated" rate which contemplates that type of return, even assuming the validity and allowable nature of all of the carrier expense claims, is clearly unjust and unreasonable and, therefore, the protested proposed rate of $6.16 filed by Sohio must be suspended.

Sohio contemplates a rate of return on total valuation before taxes of 18.8 percent. Again there is the question as to whether or not it is appropriate to impute taxes that will not actually be paid. Even assuming such taxes are imputed, the rate of return on valuation after imputed taxes is 12.9 percent. This is 4.9 percent above the Commission's past criteria of 8 percent return on valuation. Of course, if the 8 percent return on valuation is to be utilized, the imputed taxes will be reduced by comparable amounts based upon a return of 8% rather than 12.9%.

Based upon an assumption that all of Sohio's claimed expenses are to be allowed and that the "valuation" as they calculate it could be used as the basis for determining rates, the following Table calculates the maximum reasonable revenues based upon the Commission's standard of an 8 percent return on value for crude lines:

TABLE

Calculation Of TAPS Tariff Assuming 8 Percent Return On Valution And Allowance Of All Claimed Sohio Expenses

		Amount	Cents Per Barrel
		(Millions of Dollars)	
1.	Operating Expenses:		
	a. Ad Valorem Taxes	$51.0	34.93¢
	b. Operating Expenses	98.2	67.27¢
	c. Depreciation	126.2	86.44¢
	d. Total "Operating Expenses"	275.4	188.36¢
2.	Return of 8 Percent On Valuation ($3315.0 million X .08)	265.2	181.64
3.	Interest Expense	252.5	172.94
4.	Ordinary Income Before Taxes	12.7	8.70
5.	Statutory Income Taxes	6.7	4.59
	a. Alaska (9.4%)	1.2	0.82
	b. Federal (48%)	5.5	3.77
6.	Net Income	6.0	4.11
7.	Total Revenue	$547.3	374.86

Applying the Commission's criteria of an 8 percent return on valuation and allowing *arguendo* all of the operating expenses claimed by Sohio (even though, for example, depreciation is clearly overstated by approximately 24¢ per barrel through the use of a 25 year pipeline life rather than 35 years), the total fair revenue needs of Sohio are $547.3 million, which based upon a Sohio volume of 146 million barrels per year[1] establishes the total fair revenue rate to be $3.75. The addition of 9-10¢ per barrel

1. 1.2 million barrels per day total pipeline throughout X 365 days per year X 33.34 percent interest of Sohio.

for the accumulation of removal costs, which appears to be too high since it ignores the earning capacity of that removal fund and is based upon a 25 year rather than 35 year pipeline life, would bring the rate only to $3.85.

The State of Alaska opposes the use of the Commission's "valuation" as a rate base. The inherent defect and problem in the "valuation" rate base is that it is inflationary and precludes meaningful comparable earnings analysis. Since Alaska is against the use of the valuation base we do not urge that the Commission use its standard criteria of an 8 percent return on valuation as the maximum measure of the TAPS tariffs. Alaska does point out that if the Commission applied that standard as it said was required by "consistent and fair treatment", a Sohio rate no greater than $3.85 could be permitted to become effective. At minimum, the carriers have been on notice of at least 35 years that the Commission's method of determining maximum fair rates was, in fact, to allow only an 8 percent return on valuation. Carrier contentions that they have a right under I.C.C. consistent regulation to a greater amount is manifestly absurd. The fact that some carriers may have published rates based upon such absurdly erroneous assumptions and, for one reason or another, were able to have those rates go into effect *without challenge* does not mean that they are entitled to develop TAPS tariffs.

An analysis of the Union Alaska Pipeline Company submission to the Commission under date of June 14, 1977, accompanying the filing of its tariff at $6.09 per/barrel, establishes that the rate is designed to provide the equity owner with an *after* tax return of 64.3 percent on annualized basis in the first year of operation. A rate that proposes such a profit is clearly unjust and unreasonable and must be suspended. Union claims a total rate base (includ-

ing construction costs, capitalized costs, capitalized interest on financing through August 31, 1977, and capitalized supplies) totalling, as its 1.66 percent share, $144,187,000. Union also reveals that its financing includes $83,125,000 of medium and long term notes at 8.3 percent and $45,314,000 of short-term paper at 5.4 percent, for total debt financing of $128,439,000. Therefore, the maximum of Union's total *equity* TAPS cost would be $15,748,000, or 10.9 percent of the total. Since Union has calculated its tariff rate so as to return a profit *after* taxes of $3,374,000 for only one-third of a year's operation, on an annualized basis the net income available to equity after taxes would be $10,122,000, or 64.3 percent of the equity investment in Union Alaska Pipeline Company. Figures on page 2 of the Union's submission indicate that the $6.09 rate would provide a return on *valuation,* after Union's calculated deduction for imputed income taxes, of 14.0 percent, which is substantially in excess of the Commission's standard of 8 percent on crude lines.

The foregoing discussion using Sohio and Union as examples would appear to be generally applicable to all carriers. Sohio and Union have been used because they did submit, at the last hour, information to permit the foregoing analysis based upon the *carrier supplied* data. Previously submitted information from Union and the other carriers did permit the determination of the total operating expenses, including depreciation, plus interest and removal costs. The dollar amounts for these items have been compiled by specific accounts in the uniform system of accounts and are attached hereto as Appendix A. Appendix B converts those expenditures by specific accounts to a cost per/barrel. The following table gives the total operating expenses per/barrel (including depreciation and amortization, i.e., the total of accounts 300-580) as well as the total

of expenses including interest and provision for removal and restoration as reported by each of the individual carriers.

TAPS Carrier Expenses In Cents Per/Barrel

Carrier	Operating Expenses	Total Expenses
Amerada Hess	182.47¢	365.98
Arco	177.85¢	346.74
BP Pipelines	168.16¢	358.09
Exxon	175.34¢	326.89
Mobil	172.24¢	360.21
Phillips	169.84¢	320.78
Sohio	178.04¢	363.06
Union	168.45¢	310.33

SOURCE: Appendix B and letters to the I.C.C. from individual TAPS pipelines.

The foregoing figures and the more detailed presentations of the expenses per/barrel by specific categories for the individual carriers are set forth in the color graph, *supra,* at p. 15c.

Operating expenses (the total of all expenses incurred and chargeable to accounts 300-580) require only between $1.65 and $1.82 per/barrel, assuming, *arguendo* the validity and accuracy of all of the carrier projections. Of those operating expenses approximately 83-86 cents per/barrel will be in the form of depreciation and amortization charges for an unreasonably short 25 years.[1] Since depreciation and amortization reflects a non-cash expenditure and actually constitutes a recovery *of* capital invested, the cash

1. See discussion with respect to the appropriate depreciation life *infra,* pp. 45-50.

requirements to cover operating expenses are only approximately 90 cents per/barrel.

Interest expenses per/barrel vary as between the carriers from $1.32 to $1.75 per/barrel.

IV. *Depreciation and Amortization Accruals by TAPS Owners are Excessive.*

Each of the TAPS carriers have assumed a service life of only 25 years. The Commission's normal practice is to generally allow oil pipeline service lives of 35 years for crude oil trunk lines. The 25-year depreciation life submitted by TAPS owners is far less than the depreciation lives of other pipeline properties owned by these same pipeline companies. For example, in their annual report Form P submitted to the I.C.C. for the year 1976, four of the presently regulated pipelines used the following averaged depreciation rates for trunk line properties:

Depreciation Rates and Related Life for TAPS Carriers

Pipeline	Average Depreciation Rate	Related Life
Arco Pipe Line Co.	2.34%	42.74 yrs.
Exxon Pipeline Co.	3.36%	29.76 yrs.
Mobil Pipeline Co.	2.88%	34.72 yrs.
Sohio Pipe Line Co.	2.73%	36.63 yrs.

The Commission's regulations in its Uniform System of Accounts for Pipelines, 49 C.F.R. § 1204, defines depreciation as:

> "the loss in service value not restored by current maintenance and incurred in connection with the consumption or prospective retirement of property

> in the course of service from causes against which the carrier is not protected by insurance, and *the effect of which can be forecast with a reasonable approach to accuracy.* (emphasis added)

The starting point for figuring Alaskan crude reserves is the Prudhoe Bay Field. In a January 4, 1977 letter to all TAPS owners this Commission asked, *inter alia,* for the companies to supply information on the "total number of barrels of known recoverable oil reserves in the Prudhoe Bay Field and any other fields that can reasonably be expected to produce oil that will be transported through TAPS." The oil pipeline responses to the ICC query indicate that for purposes of figuring depreciation rates, they are using the figure of 9.5-9.7 billion barrels of known recoverable reserves, making TAPS economically viable for a 25 year period. However, the figure of 9.5-9.7 billion barrels does not include "any other fields that can reasonably be expected to produce oil that will be transported through TAPS" nor does it even include all of the Prudhoe Bay Field. Within the Prudhoe Bay Field are two other pools in addition to the main Prudhoe Oil Pool—the Lisburne and Kuparuk Oil Pools. These latter two pools are estimated to contain on the order of 1.3 to 2.1 billion barrels of crude.[1] The oil in these two other pools is acknowledged to exist by the oil companies but the reason given for not including it in known recoverable reserves is that "it has not been determined to be capable of commercial production."[2] We submit that there is almost complete cer-

1. "President's April 15, 1977, Report to Congress on the Pricing of Alaska North Slope (ANS) Crude Oil" at p. 77.

2. Letter to I.C.C. from Arco Pipe Line Company, March 2, 1977, signed by H. H. Baden for J. D. Wessling, Comptroller-Treasurer and Manager-Administrative and Control.

tainty that at some point during the life of TAPS these additional pools will be commercially produced unless the high TAPS tariffs render them economically unrecoverable and this Commission should, accordingly, include these amounts of reserves for purposes of figuring the service life of TAPS. The Lisburne and Kuparuk Oil Pools taken alone will add an additional 3-5 years to the service life of TAPS based on a flow of 1.2 MMBD.

There is reasonable certainty that undiscovered recoverable reserves exist outside the Prudhoe Bay Field. Areas that may contain potentially recoverable reserves include Naval Petroleum Reserve Four and the Beaufort and Chukchi Sea areas. It is possible to cite many statistics but perhaps the most overwhelming one comes from the U.S. Geological Survey which estimates that there is a 95% probability that there is *at least* 9 billion more barrels of undiscovered but recoverable crude oil reserves within onshore Alaska and in offshore waters![1] TAPS is the only foreseeable way that this oil will move from the North Slope.

The oil companies themselves acknowledge the tremendous potential reserves on the North Slope. Less than one month ago an Atlantic Richfield Vice President, testifying at an FEA hearing in Anchorage, Alaska on Alaska North Slope crude oil pricing and entitlement treatment made the following statements:

> "Overall, the U.S. Geological Survey estimates the undiscovered recoverable resources for North Alaska to be about 20 billion barrels of oil and 57 trillion

1. Table, 4. p. 28-29, Geological Estimates of Undiscovered Recoverable Oil and Gas Resources in the United States, Geological Survey Circular 725. Undiscovered recoverable reserves are those reserves yet undiscovered but estimated to exist in favorable geologic settings on the basis of broad geological knowledge and theory *and* which are estimated to be economically recoverable. See *Id.* at 8-9.

> cubic feet of natural gas. The study conducted for the FEA by Mortada International estimated the speculative reserves in the Kuparuk and Lisburne formations at 1.3 to 2.1 billion barrels. Although one can argue with one or more of the specific assumptions made in these studies, *Atlantic Richfield also feels that there is a high potential for additional reserves in North Alaska . . .*"[1]

Later, referring to the Kuparuk and Lisburne formation, the same Arco official stated that under FEA's proposed pricing and entitlements treatment

> ". . . we would expect our North Slope exploration program within the next 12 months to include several exploratory wells to evaluate and delineate the Kuparuk and Lisburne formation. If this program were to be successful, it would lead to a substantial development program with production starting in the early 1980's.[2]

In its January 4, 1977 letter to the pipeline companies, this Commission also asked the companies to "estimate the ownership life of the line." It was made clear that this inquiry was directed at economic ownership, not physical life.[3] The responses of at least two of the companies are inconsistent with the claimed 25 year depreciation life. Atlantic Richfield estimated the ownership life to be

1. Testimony of Howard A. Slack, Area Vice-President, at Federal Energy Administration Hearing in Anchorage, Alaska, May 27, 1977 at pp. 2-3.

2. Id. at p. 3.

3. March 23, 1977 Memorandum by E. Hostettler, I.C.C. Bureau of Accounts, in response to inquiry by Mobil Alaska Pipeline Company; see also letter to I.C.C. from Sohio Pipeline Company, April 29, 1977 in response to I.C.C. request of January 4, 1977.

30 years, adding that the 30 years is also "the initial term of the TAPS Agreement."[1] Phillips Petroleum replied: "The estimated life of the line would be based on the liquid productive life of the Prudhoe Bay Field, which is approximately 30 years."[2] One has to question why a TAPS agreement would be made for 30 years if the pipeline will only be operating 25 years.

As previously mentioned, the Uniform System of Accounts definition of depreciation refers to a loss of service life "the effect of which can be forecast with a reasonable approach to accuracy." In its January 4, 1977 letter to the pipeline companies, this Commission was attempting to gather information to make such a forecast when it asked the pipeline companies to supply information on the reserves in the Prudhoe Bay Field and other fields that are reasonably expected to produce oil that will flow through TAPS. And while the pipelines, despite their inconsistent statements, failed to respond to the inquiry, this Commission can, of course, rely upon other independent sources of information. We submit that, when analyzing functional depreciation related to the exhaustion of supply, it not only is reasonably accurate to include recoverable reserves that have a 95% probability of existing, but that it is inaccurate *not* to include such reserves, especially since these reserves must be transported through TAPS.

Strong support for rejecting the 25-year service life estimate submitted by TAPS-owners comes from a recent case where similar issues were before the court. *Memphis Light, Gas & Water Div.* v. *FPC,* 504 F. 2d 225 (1974). In that

1. Letter to I.C.C. from Arco Pipeline Company, March 2, 1977, signed by J. D. Wessling, Comptroller-Treasurer and Manager-Administration and Control.

2. Letter to I.C.C. from Phillips Petroleum Company, February 25, 1977, signed by W. S. Griffin, Jr., Manager-Valuation Section.

case the FPC had granted a natural gas pipeline company's request for an increase in its depreciation rate due to a claimed future exhaustion in supply. The D.C. Circuit Court reversed, holding that while exhaustion of natural resources can be taken into account for purposes of determining depreciation rates, the FPC, when it substitutes a higher reserve-life-based depreciation rate in place of a previously used and lower physical-life-based rate, must affirmatively find an exhaustion of natural resources. The Court concluded:

> "However, it is for the Commission, not the utility, to determine a depreciation charge that is proper and adequate. The Commission cannot indulge the utility in an abstract projection which is premised on termination of service and which amounts to a "worst case" analysis." (504 F.2d at 234)

By calculating depreciation rates based solely on reserves from the main Prudhoe Bay Field, while ignoring the two other oil pools within the Prudhoe Bay Field and all the other vast recoverable reserves on the North Slope, the pipeline companies are engaging in a worst case analysis.

This Commission, then, should reject a TAPS 25 year service life on the grounds that it is based solely on functional depreciation relating to exhaustion of supply and, as shown above, there is almost complete certainty that additional reserves will become available for transportation through TAPS. Only a worst case analysis would permit the 25 year figure to stand; common sense and case law argue against using such an analysis. The magnitude of the expected recoverable reserves and the fact that all recovered reserves must be transported through TAPS precludes the use of exhaustion of supply as a measuring

life for TAPS. In place of the 25 year service life, this Commission should substitute the normal 35 life for pipelines unless the TAPS-owners can affirmatively demonstrate that the *physical* life of TAPS should be less.

V. *Maximum Initial TAPS Tariff Determination*

It is obvious from the extensive submission by Mr. Lenzner that there are very serious questions as to the manner in which the TAPS line was constructed and as to the allowable nature of hundreds of millions of dollars in the initial cost of construction in light of the requirement that service be provided "at the lowest cost consistent with the provision of such service" under "honest, economical and efficient manner." The related interest during construction further inflates the cost to be borne by the ratepayers and the public. The entire project was apparently approached with a cost plus attitude. Such an approach would only be possible where the resulting line would be in monopoly position and face no meaningful risk of competition or any possible likelihood that the investment would not be able to be recovered. At the time money was expended on the pipeline, oil had already been discovered. It was known that the oil would be produced and would move at almost any rate which might conceivably be charged, even rates exceeding $6.00 per barrel.

None of the "hazards and risks" referred to by the Commission in its earlier pipeline cases are present here except the absurd "risk" allegedly resulting from the fact that a pipeline is "depended upon the volume of movement of one commodity in one direction."[1] We submit that under the circumstances of this case the volumes of movement are and have been accurately predictable. There is no question of the ability of the shippers to develop or purchase oil in

1. *Minnelusa Oil Corp.* v. *Continental Pipe Line Co.*, 258 I.C.C. 41, 51 (1944).

the fields. There is absolutely no risk of alleged "changes in market demand". Nor is there any risk in the "diminishment of the supply of oil in the fields served" in view of the magnitude of the field involved and the potential for the development of other "recoverable reserves" as long as the tariff is not so high as to discourage further development and economic recovery of oil resources. There is no likelihood and therefore no risk that there will be a "shifting of sources of supply through the discovery of new oil reserves or increased production nearer the refinery points" so that the Alaskan North Slope Oil moved through TAPS would no longer be marketable. Because of the cost plus mentality with which the project was approached, it is the position of the State of Alaska that there is minimum risk involved for the equity owners and therefore they are entitled to minimum returns, particularly where there is substantial evidence that the operation as constructed does not reflect the lowest cost consistent with the provision of service under honest, economic and efficient management. Alaska submits that the proper way to determine the reasonable tariff is to allow a return on no more than the reasonable amount of a prudent investment in the used and useful property less all accumulated depreciation. It is also imperative that the Commission, in ultimately determining just and reasonable rates, must make a detailed analysis of the cost of capital including the effect flowing from any imputation of taxes not actually paid. Tax deferral is also a "tax savings" of sort since the taxpayer has the use of the money which would be used to pay the tax for the period during which the tax is deferred.[1] Present consumers should be given credit for the use value of or interest on the deferred tax payment.[2]

1. *People of the State of California* v. *FPC*, 506 F. 2d. 228, (D.C. Cir. 1974).
2. *Ibid.*

Even without being able to evaluate each of these items in detail, because of the lack of information provided by the pipelines, Alaska submits that the overwhelming evidence shows the grossly unreasonable nature of the protested tariffs. Accompanying this protest is a "preliminary analysis of the tariffs filed with the ICC by the owners of TAPS", prepared by Dr. Michael J. Ileo, President, Technical Associates, Inc. Given the data currently available to him, particularly as to the financial structure and the cost of capital, and building upon some of the projected expenses for the operation of TAPS, Dr. Ileo has made preliminary determinations of the level of TAPS tariffs which will yield a fair return on each owner's equity investment in TAPS. Dr. Ileo's statement is incorporated by reference herein.

Based on data submitted to date and estimates derived therefrom, our preliminary analysis reveals that the TAPS tariffs currently filed with the ICC will yield excessive profits to the owning companies. Specifically, we find that:

Owning Company	Filed Tariff	Estimated Profit Rate on Equity
SOHIO	$6.16	264.0%
BP	$6.35	37.6%
ARCO	$6.04	66.0%
EXXON	$6.27	62.2%
MOBIL	$6.31	(Note[1])

1. Estimated return is infinitely high since the 1976 annual report of Mobil Alaska Pipeline indicates a negative equity position.

Dr. Ileo has separately determined the level of tariffs which would yield rates of return on the equity of the five

major companies involved in TAPS at a return of 11, 13 and 15 percent on equity. Those tariffs would be as follows:

Owning Company	Profit Rate On Equity	Tariff
SOHIO	11%	$4.04
SOHIO	13%	4.06
SOHIO	15%	4.08
BP	11%	$4.42
BP	13%	4.56
BP	15%	4.71
ARCO	11%	$3.74
ARCO	13%	3.82
ARCO	15%	3.91
EXXON	11%	$3.80
EXXON	13%	3.90
EXXON	15%	3.99
MOBIL	11%[1]	$3.59
MOBIL	13%	3.59
MOBIL	15%	3.59

1. No equity investment.

It is submitted, as discussed above, that pending the completion of the entire investigation, no tariff should be permitted to go into effect which would allow more than a minimum return to the equity owners. We submit that a return of more than 11 percent would, under the circumstances as presently known, be unjust and unreasonable.

Because the pipeline industry in Ex Parte 308 has made a generalized argument that pipelines are entitled to a 13-14 percent rate of return, Dr. Ileo has calculated the tariffs that would be required to provide such an overall rate of return and what such overall rates of return imply as the

equity rates of return. We emphasize that the 13 to 14 percent is an overall rate of return in connection with which the cost of debt (with debt supporting 85% of the investment) being 8.7 percent. Tariffs based on an overall rate of return of 13 and 14 percent would imply an average rate of return on equity, after taxes, of 37.4 percent and 44 percent, respectively. We submit that rates determined on such a basis, which rates would appear to be $5.86 and $6.30 cents per barrel, respectively, are unjust and unreasonable and should not be permitted to become effective.

CONCLUSION

The state of Alaska submits that the foregoing information and all of the data made available by the carriers to date imperatively requires the entry of an order by the Commission suspending the effectiveness of the protested TAPS tariffs. This suspension should be without prejudice to the filing of lower tariffs which would (1) reflect depreciation and amortization over no less than 35 years, (2) inclusion in the base for both depreciation and return calculations of no more than the lowest amount consistent with the provision of service under the standard of economical and efficient management, (3) returns to equity owners of no more than 11 percent in connection with the initial tariffs, with further consideration of the substantial amount

of capital which will be made available through deferred taxes at no cost to the carriers.

Dated at Washington, DC this 15th day of June, 1977.

Respectfully submitted,

THE STATE OF ALASKA:

By: Avrum M. Gross, Attorney General
Richard M. Burnham, Assistant
Attorney General
Pouch K—State Capitol
Juneau, AK 99811

JOHN M. CLEARY
FREDERIC L. WOOD
EDWARD J. TWOMEY
CHRISTOPHER C. JANKU
Donelan, Cleary, Wood & Maser
914 Washington Building
Washington, DC 20005
(202) 783-1215

Attorneys

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Appendix A
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PER-BARREL EXPENSES OF TAPS CARRIERS BY SPECIFIC ACCOUNT
(CENTS PER BARREL)

		Alyeska (100%)	Amerada Hess (1.5%)	Arco PL (21%)	BP Pipelines (15.846%)	Exxon PL (20%)
	OPERATIONS					
300	Salaries and Wages	2.10	2.10	2.10	2.10	2.10
310	Supplies and Expenses	1.35	1.35	1.35	1.35	1.35
320	Outside Services	1.24	1.25	1.25	1.24	1.24
330	Operating Fuel and Power	6.51	9.02	14.77	9.02	11.64
340	Oil Losses and Shortages	-	-	-	-	-
	Total Operations	11.20	13.72	19.47	13.71	16.33
	MAINTENANCE					
400	Salaries and Wages	1.51	1.52	1.51	1.51	1.51
410	Supplies and Expenses	.89	.89	.93	1.05	.89
420	Outside Services	17.67	17.67	17.67	17.67	17.67
430	Maintenance Materials	1.97	1.97	1.97	1.81	1.97
	Total Maintenance	22.04	22.05	22.08	22.04	22.04
	GENERAL					
500	Salaries and Wages	4.08	4.07	4.08	5.09	4.53
510	Supplies and Expenses	1.50	1.53	1.54	2.37	1.55
520	Outside Services	5.54	12.90	5.54	6.62	5.70
530	Rentals	1.67	1.67	1.67	1.78	1.70
540	Depreciation and Amortization	-	85.73	83.93	74.95	84.13
550	Pensions and Benefits	1.40	1.40	1.40	1.63	1.53
560	Insurance	.91	1.64	.91	1.88	.91
570	Casualty and Other Losses	-	-	-	.14	-
580	Pipeline Taxes	.52	37.76	37.23	37.95	36.93
	Total General, (Outside Service Accts. 320,420, 520)	15.62	146.70	136.30	132.41	136.97
	Sub Total: Operating Expenses	24.45 48.86	31.82 182.47	24.46 177.85	25.53 168.16	24.61 175.34
	OTHER					
650	Interest Expense	2.12	173.94	154.54	171.36	132.83
60	Provision for removal and restoration	-	9.57	14.35	9.57	18.72
	Total Other	2.12	183.51	168.89	180.93	151.55
	GRAND TOTAL	50.98	365.98	346.74	358.09	326.89

Appendix A
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PER-BARREL EXPENSES OF TAPS CARRIERS BY SPECIFIC ACCOUNT
(CENTS PER BARREL)

		Mobil Alaska PL (5.%)	Phillips Pet. Co. (1.666%)	SOHIO PL (33.34%)	Union Alaska PL (1.666%)
	OPERATIONS				
300	Salaries and Wages	2.10	2.10	2.10	2.10
310	Supplies and Expenses	3.17	1.35	1.35	1.35
320	Outside Services	1.25	1.24	1.25	1.25
330	Operating Fuel and Power	5.89	6.51	7.19	9.18
340	Oil Losses and Shortages	-	-	-	-
	Total Operations	12.41	11.20	11.89	13.88
	MAINTENANCE				
400	Salaries and Wages	1.51	1.51	1.52	1.52
410	Supplies and Expenses	1.05	.89	.89	.89
420	Outside Services	17.67	17.67	17.68	17.68
430	Maintenance Materials	1.81	1.97	1.98	1.98
	Total Maintenance	22.04	22.04	22.06	22.06
	GENERAL				
500	Salaries and Wages	4.08	4.08	4.12	4.09
510	Supplies and Expenses	1.54	1.54	1.55	1.54
520	Outside Services	7.17	5.89	8.14	6.04
530	Rentals	1.67	1.67	3.34	1.67
540	Depreciation and Amortization	82.55	83.36	86.42	79.08
550	Pensions and Benefits	1.40	1.40	1.41	1.40
560	Insurance	1.82	.91	1.74	.91
570	Casualty and Other Losses	-	-	-	-
580	Pipeline Taxes	37.76	37.75	37.76	37.76
	Total General (Outside Services Accts. 320, 420, 520)	137.79	136.60	144.48	132.51
	Sub Total: Operating Expenses	26.09 172.24	24.80 169.84	178.4	24.97 168.45
	OTHER				
650	Interest Expense	149.19	141.37	175.03	132.29
660	Provision for removal and restoration	38.78	9.57	9.59	9.59
	Total Other	187.97	150.94	184.62	142.88
	GRAND TOTAL	360.21	320.78	363.06	310.33

Protest of the State of Alaska Seeking Suspension.

Appendix B
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EXPENSES OF TAPS CARRIERS BY SPECIFIC ACCOUNT
($000)

		Alyeska (1001)	Amerada Hess (1.59)	Arco PL (210)	BP Pipelines (15.84%)	Exxon PL (200)
OPERATIONS						
300	Salaries and Wages	9205	138	1933	1,458	1841.0
310	Supplies and Expenses	5918	89	1242	937	1103.6
320	Outside Services	5471	82	1148	867	1094.2
330	Operating Fuel and Power	28528	593	13590	6,261	10205.6
340	Oil Losses and Shortages	-	-	-	-	-
	Total Operations	49122	902	17913	9,523	14324.4
MAINTENANCE						
400	Salaries and Wages	6643	100	1395	1,052	1328.6
410	Supplies and Expenses	3917	59	862	732	783.4
420	Outside Services	77418	1,161	16257	12,263	15483.6
430	Maintenance Materials	8661	130	1818	1,261	1732.2
	Total Maintenance	96639	1,450	20332	15,308	19327.8
GENERAL						
500	Salaries and Wages	17897	268	3758	3,535	3974.4
510	Supplies and Expenses	6758	101	1419	1,651	1401.6
520	Outside Services	24303	848	5103	4,594	5000.6
530	Rentals	7333	110	1539	1,239	1496.6
540	Depreciation and Amortization	-	5,754	77200	52,000	73700.0
550	Pensions and Benefits	6158	92	1293	1,135	1341.6
560	Insurance	4000	108	840	1,307	800.0
570	Casualty and Other Losses	-	-	-	100	-
580	Pipeline Taxes	2283	2,481	-	26,331	32,356.6
	Total General (Outside Services Accts. 320, 420, 520)	68,732	5,782	35652	91,892	130,071.4
	Sub Total: Operating Expenses	107,192	2,091	22,508	17,724	21,578.4
		214,493	12,114	165,049	116,723	153,723.6
OTHER						
650	Interest Expense	9304	11,428	13,200	7,178	16,400.0
660	Provision for removal and restoration	-	629	155,353	126,067	132,780.8
	Total Other	9304	12,057	320,402	242,790	286,484.4
GRAND TOTAL		$223,797	24,171			

Protest of the State of Alaska Seeking Suspension.

Appendix B
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EXPENSES OF TAPS CARRIERS BY SPECIFIC ACCOUNT
($000)

		Mobil Alaska PL (5.67)	Phillips Pet. Co. (1.66)	Exxon PL (31.56%)	Union Alaska PL (1.66%)
OPERATIONS					
300	Salaries and Wages	460.3	152.8	2069.0	152.000
310	Supplies and Expenses	695.0	90.2	1973.0	90.240
320	Outside Services	263.6	90.8	1024.0	90.830
330	Operating Fuel and Power	1290.0	671.5	10,500.0	667.570
340	Oil Losses and Shortages	-	-	-	-
	Total Operations	3710.9	815.3	17,566.0	1,000.930
MAINTENANCE					
400	Salaries and Wages	333.2	110.3	2215.0	110.270
410	Supplies and Expenses	331.0	65.1	1366.0	65.020
420	Outside Services	3870.9	1205.1	25,011.0	1205.130
430	Maintenance Materials	397.9	143.4	2881.0	141.720
	Total Maintenance	4933.0	1523.9	31,506.0	1001.110
GENERAL					
500	Salaries and Wages	886.9	297.1	6012.0	297.000
510	Supplies and Expenses	337.9	113.1	2265.0	112.180
520	Outside Services	1571.3	438.7	11,453.0	439.430
530	Rentals	346.6	121.7	4085.0	121.730
540	Depreciation and Amortization	16080.0	6661.2	136,200.0	5750.000
550	Pensions and Benefits	307.9	102.2	2089.0	102.220
560	Insurance	400.0	66.4	2334.0	66.400
570	Casualty and Other Losses	-	-	-	-
580	Pipeline Taxes	8269.5	2745.4	18,144.0	2745.490
	Total General (Outside Services Accts. 320, 420, 520)	30338.8	9532.8	215,381.0	8638.348
	Sub Total: Operating Expenses	5705.7	1004.6	360,570.6	1015.400
		37778.9	11334.4		12240.180
OTHER					
650	Interest Expense	32674.0	10279.4	235,603.0	9618.440
660	Provision for removal and restoration	4313.5	696.5	14,000.0	492.000
	Total Other	36987.5	10975.9	249,603.0	10315.440
GRAND TOTAL		78953.4	23310.2	330,172.0	22563.620

Protest of the State of Alaska Seeking Suspension.

STATEMENT OF DR. MICHAEL J. ILEO

PRELIMINARY ANALYSIS OF THE TARIFFS FILED WITH THE ICC BY THE OWNERS OF TAPS

This report is prepared by Technical Associates, Incorporated under the direction of Dr. Michael J. Ileo. The purpose of the report is to determine, given data which are currently available, tariffs for the pipeline services provided by the major owners of TAPS which will yield a fair return on each owner's equity investment in TAPS. The report must be viewed as preliminary since all of the owners of TAPS had not submitted complete data to the ICC at the time of this writing. For example, a number of expense items for some of the owners were estimated using data which had been submitted by other owners.

Based on data submitted to date and estimates derived therefrom, our preliminary analysis reveals that the TAPS tariffs currently filed with the ICC will yield excessive profits to the owning companies. Specifically, we find that:

Owning Company	Filed Tariff	Estimated Profit Rate on Equity
SOHIO	$6.16	264.0%
BP	$6.35	37.6%
ARCO	$6.04	66.0%
EXXON	$6.27	62.2%
MOBIL	$6.31	(Note[1])

1. Estimated return is infinitely high since the 1976 annual report of Mobil Alaska Pipeline indicates a negative equity position.

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In contrast to the excessive equity returns associated with the filed tariffs, rates of return on equity of 11%, 13% and 15% yield the following tariffs:

Owning Company	Profit Rate On Equity	Tariff
SOHIO	11%	$4.04
SOHIO	13%	4.06
SOHIO	15%	4.08
BP	11%	$4.42
BP	13%	4.56
BP	15%	4.71
ARCO	11%	$3.74
ARCO	13%	3.82
ARCO	15%	3.91
EXXON	11%	$3.80
EXXON	13%	3.90
EXXON	15%	3.99
MOBIL	11%[2]	$3.59
MOBIL	13%	3.59
MOBIL	15%	3.59

2. No equity investment.

Schedule 1

This schedule presents the distribution of Alyeska's estimated costs of annual operations of TAPS at a throughput of 1.2 million barrels per day. This column entitled "Alyeska" shows the distribution of estimated Alyeska costs by account developed from the cost data provided to the ICC by Exxon in its letter of June 1, 1977. The other columns in Schedule 1 show the pro-rata share of the Alyeska estimate for each owner based on the owner's

share in TAPS. For example, Sohio's share of Account 300, Salaries and Wages, is $3,068.95, which is 33.34% of Alyeska's estimate of $9,205.0.

Several of the accounts do not have estimated costs for Alyeska operations. Most notable are Accounts 540 (Depreciation and Amortization) and Account 660 (Prov. Removal & Restoration).

Schedule 2

Schedule 2 consists of three pages. The Schedule shows by account the accumulative cost data which have been submitted to date. The estimated costs are shown for each of the eight owners in three columns. Using Exxon as an example, the column entitled "Exxon-Alyeska Portion" is the pro-rata share of Alyeska costs from Schedule 1. The column "Exxon-Additional" presents the cost estimates provided by Exxon in their June 1, 1977 submission to the ICC. Column "Total" is the sum of the other two columns, indicating the total estimated costs to Exxon including their 20% share of Alyeska costs.

Of the eight owners, two (Sohio and Phillips) have not provided any of their own additional cost estimates. The six owners providing additional cost estimates for Account 660 (Prov. for Removal & Restoration) have used two different approaches. One approach (example Exxon) develops an annual estimated cost for Account 660 by assuming an escalation in the Alyeska estimate of $1.049 billion over the 25-year life of the pipeline. The other approach assumes that the owner's annual share of the $1.049 billion over the 25 years is the percentage ownership in TAPS without escalation. In our calculations of tariffs in Schedules 5A-9A, we used the latter approach in

determining the estimated costs for Account 660 for each owner. Therefore, in the calculations of the individual tariffs, the Removal & Restoration costs [Line (5), Schedules 5A-9A] do not agree with the estimates provided by the owners in Schedule 2.

Schedule 3

Schedule 3 shows the distribution of the estimated removal and restoration costs based on the Alyeska estimate of $1.049 billion. The total annual amount of $41,960 ($1,049,000 ÷ 25 = $41,960) is apportioned to the owners based on their shares of TAPS. The estimated amounts for each owner are used in Line (5) of the tariff calculations. We do not think it is appropriate to escalate the estimate removal and restoration costs (estimated in 1977 dollars) and set aside a constant amount each year for the 25 years without discounting the annual amount.

Schedule 4

The schedule presents the methodology used to calculate State Income Tax [Line (8)] and Federal Income Tax [Line (9)] in Schedules 5A-9A. The assumptions are that the Federal income tax rate is 48% and the state income tax rate is 9.4%.

Schedules 5A and 5B to 9A and 9B

In this series of schedules for five of the owners constituting about 95 percent of the ownership, there are calculations of debt costs in Schedules B which are used in the various cost and tariff calculations in Schedules A. In the first three columns of each Schedule A, tariffs are calculated assuming 11, 13 and 15 percent returns on equity. These calculations directly use certain minor costs from

Schedules 1 to 3. However, in the case of operating expenses, general expenses and depreciation and amortization, estimates were made in a consistent manner for all companies as detailed in the footnotes. Given the information available, the estimates are the best attainable at this time. In the last column of each Schedule A is a cost breakdown associated with the tariff filed by each owner.

In calculating tariffs at an 11, 13 and 15 percent return on equity, one sees that the tariffs are well below the filed $6.00 to $6.40 range at $3.60 to $4.70. Our tariff differences across the companies seem realistic given the across company variation in the cost of capital and capital structure. Note that Mobil is a bit of an anamoly among the five as it has no equity capital. Thus, the fourth column on Schedule 9A is unattainable.

Schedules 10 and 11

In Schedule 10, a debt cost for TAPS (consolidated) is calculated. The debt cost for each company is derived from Schedules 5B to 9B. On Schedule 11, the consolidated debt cost is used to calculate single tariffs at overall rates of return of 13 and 14 percent on rate base given a consolidated debt ratio of 85%. In the calculations, the rate base was estimated using Exxon's reporting of depreciation and amortization and assuming a twenty-five year amortization and depreciation period. Estimated expenses for the consolidated company were used. Again, operating costs and depreciation had to be estimated as detailed in the footnotes. The bottom line shows tariffs of $5.86 and $6.30 at 13 and 14 percent overall rates of return. This implies equity rates of return of 37.4 and 44.0 percent, respectively.

Schedule 12

This schedule shows a cents per barrel breakdown for each of the major owners under the assumption of an 11 percent return on the equity investment.

Schedule 1

DISTRIBUTION[1] OF 1978 ESTIMATED ALYESKA COSTS
AT 1.2 MILLION BARRELS PER DAY AMONG OWNERS OF TAPS
($000)

Acct. No.	Account Designation	Alyeska[2]	Sohio (33.34%)	BP (15.84%)	ARCO (21%)	PHILLIPS (1.66%)	UNION (1.66%)	MOBIL (5%)	EXXON (20%)	HESS (1.5%)
	OPERATIONS									
300	Sal. & Wages	$ 9,205.0	$ 3,068.95	$ 1,458.07	$ 1,933.05	$ 152.80	$ 152.80	$ 460.25	$ 1,841.00	$ 138.08
310	Suppl. & Exp.	5,918.0	1,973.06	937.41	1,242.78	98.24	98.24	295.90	1,183.60	88.77
320	Outside Serv.	5,471.0	1,824.02	866.61	1,148.91	90.82	90.82	273.55	1,094.20	82.07
330	Oper. Fuel & Power	28,528.0	9,511.24	4,518.84	5,990.88	473.56	473.56	1,426.40	5,705.60	427.92
340	Oil L & S									
	TOTAL	$49,122.0	$16,377.27	$ 7,780.93	$10,315.62	$ 815.42	$ 815.42	$ 2,456.10	$ 9,824.40	$ 736.84
	MAINTENANCE									
400	Sal. & Wages	$ 6,643.0	$ 2,214.78	$ 1,052.25	$ 1,395.03	$ 110.27	$ 110.27	$ 332.15	$ 1,328.60	$ 99.65
410	Supp. & Exp.	3,917.0	1,305.93	620.45	822.57	65.02	65.02	195.85	783.40	58.76
420	Outside Serv.	77,418.0	25,811.16	12,263.01	16,257.78	1,285.14	1,285.14	3,870.90	15,483.60	1,161.27
430	Maint. Mat'ls.	8,661.0	2,887.54	1,371.90	1,818.81	143.77	143.77	433.05	1,732.20	129.92
	TOTAL	$96,639.0	$32,219.45	$15,307.61	$20,294.19	$1,604.20	$1,604.20	$ 4,831.95	$19,327.80	$1,449.60
	GENERAL									
500	Sal. & Wages	$17,897.0	$ 5,966.86	$ 2,834.88	$ 3,758.37	$ 297.09	$ 297.09	$ 894.85	$ 3,579.40	$ 268.46
510	Supp. & Exp.	6,758.0	2,253.12	1,070.47	1,419.18	112.18	112.18	337.90	1,351.60	101.37
520	Outside Serv.	24,303.0	8,102.61	3,849.60	5,103.63	403.43	403.43	1,215.15	4,860.60	364.55
530	Rentals	7,333.0	2,444.82	1,161.55	1,539.93	121.73	121.73	366.65	1,466.60	109.99
540	Deprec. & Amort.	6,158.0	2,053.08	975.43	1,293.18	102.22	102.22	307.90	1,231.60	92.37
550	Pensions & Ben.	4,000.0	1,333.60	633.60	840.00	66.40	66.40	200.00	800.00	60.00
560	Insurance									
570	Casualty & Loss	2,283.0	761.14	361.63	479.43	37.90	37.90	114.15	456.60	34.25
580	Pipeline Taxes	$68,732.0	$22,915.23	$10,887.16	$14,433.72	$1,140.95	$1,140.95	$ 3,436.60	$13,746.40	$1,030.95
	TOTAL									
	OTHER									
650	Interest Exp.	$ 9,304.0	$ 3,101.95	$ 1,473.75	$ 1,953.84	$ 154.45	$ 154.45	$ 465.20	$ 1,860.80	$ 139.56
660	Prov. Removal & Res.									
	TOTAL	$ 9,304.0	$ 3,101.95	$ 1,473.75	$ 1,953.84	$ 154.45	$ 154.45	$ 465.20	$ 1,860.80	$ 139.56
	GRAND TOTAL	$223,797.0	$74,613.90	$35,449.45	$46,997.37	$ 3,715.02	$ 3,715.02	$11,189.85	$44,759.40	$ 3,356.99

[1]Distribution based on ownership. [2]Developed from Exxon June 1, 1977 submission to ICC (letter by J. D. Sturtevant).

Schedule 2
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DISTRIBUTION OF TOTAL TAPS 1978 ESTIMATED COSTS
AT 1.2 MILLION BARRELS PER DAY AMONG TAPS OWNERS
BASED ON SUBMISSIONS TO ICC
($000)

Acct. No.	Account Designation	Sohio-Alyeska Portion	Sohio Additional[1]	Sohio Total	BP-Alyeska Portion	BP Additional	BP Total[2]	Alyeska Portion	ARCO Additional[3]	Total
	OPERATIONS									
300	Sal. & Wages	$ 3,068.95			$ 1,458.07		$ 1,458.0	$ 1,933.05		
310	Suppl. & Exp.	1,973.06			937.41		937.0	1,242.78		
320	Outside Serv.	1,824.02			866.61		867.0	1,148.91		
330	Oper. Fuel & Power	9,511.24			4,518.84		6,261.0	5,990.88		
340	Oil L & S									
	TOTAL	$16,377.27			$ 7,780.93		$ 9,523.0	$10,315.62		
	MAINTENANCE									
400	Sal. & Wages	$ 2,214.78			$ 1,052.25		$ 1,052.0	$ 1,395.03		
410	Supp. & Exp.	1,305.93			620.45		732.0	822.57		
420	Outside Serv.	25,811.16			12,263.01		12,263.0	16,257.78		
430	Maint. Mat'ls.	2,887.58			1,371.90		1,261.0	1,818.81		
	TOTAL	$32,219.45			$15,307.61		$15,308.0	$20,294.19		
	GENERAL									
500	Sal. & Wages	$ 5,966.86			$ 2,834.88		$ 3,535.0	$ 3,758.37		
510	Supp. & Exp.	2,253.12			1,070.47		1,651.0	1,419.18		
520	Outside Serv.	8,102.61			3,849.60		4,594.0	5,103.63		
530	Rentals	2,444.82			1,161.55		1,239.0	1,539.93		
540	Deprec. & Amort.						52,000.0			
550	Pensions & Ben.	2,053.08			975.43		1,135.0	1,293.18		
560	Insurance	1,333.60			633.60		1,307.0	840.00		
570	Casualty & Losss									
580	Pipeline Taxes	761.14			361.63		26,331.0	479.43		
	TOTAL	$22,915.23			$10,887.16		$91,892.0	$14,433.72		
	OTHER									
650	Interest Exp.	$ 3,101.95			$ 1,473.75		$118,889.0	$ 1,953.84		
660	Prov. Removal & Res.						7,178.0			
	TOTAL	$ 3,101.95			$ 1,473.75		$126,067.0	$ 1,953.84		
	GRAND TOTAL	$74,613.90			$35,449.45			$46,997.37		

Schedule 2
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DISTRIBUTION OF TOTAL TAPS 1978 ESTIMATED COSTS
AT 1.2 MILLION BARRELS PER DAY AMONG TAPS OWNERS
BASED ON SUBMISSIONS TO ICC
($000)
(CONTINUED)

Acct. No.	Account Designation	Alyeska Portion	Exxon Additional[4]	Total[4]	Alyeska Portion	Mobil Additional[5]	Total	Alyeska Portion	Union Additional[6]	Total
	OPERATIONS									
300	Sal. & Wages	$ 1,841.0			$ 460.3		$ 460.3	$ 152.80		$ 152.80
310	Suppl. & Exp.	1,183.6			295.90		695.0	98.24		98.24
320	Outside Serv.	1,094.2			273.6		273.6	90.82		90.82
330	Oper. Fuel & Power	5,705.6	$ 4,500.0	$10,205.6	1,426.40		1,290.0	473.56		667.57
340	Oil L & S									
	TOTAL	$ 9,824.4	$ 4,500.0	$14,324.4	$ 2,456.20		$ 2,718.9	$ 815.42		$ 1,009.43
	MAINTENANCE									
400	Sal. & Wages	$ 1,328.60			$ 322.15		$ 322.2	$ 110.27		$ 110.27
410	Supp. & Exp.	783.40			195.85		231.0	65.02		65.02
420	Outside Serv.	15,483.60			3,870.90		3,870.9	1,285.14		1,285.15
430	Maint. Mat'ls.	1,732.20			433.05		397.9	143.77		143.77
	TOTAL	$19,327.80		$19,327.8	$ 4,831.95		$ 4,832.0	$ 1,604.20		$ 1,604.21
	GENERAL									
500	Sal. & Wages	$ 3,579.40	$ 395.0	$ 3,974.4	$ 894.85		$ 894.9	$ 297.09		$ 297.09
510	Supp. & Exp.	1,351.60	50.0	1,401.6	337.90		337.9	112.18		112.18
520	Outside Serv.	4,860.60	140.0	5,000.6	1,215.15		1,571.2	403.43		439.43
530	Rentals	1,466.60	30.0	1,496.6	366.65		366.6	121.73		121.73
540	Deprec. & Amort.		73,700.0	73,700.0		$18,080.0	18,080.0		$ 5,750.0	5,750.0
550	Pensions & Ben.	1,231.60	110.0	1,341.6	307.90		307.90	102.22		102.22
560	Insurance	800.00		800.00	200.00		400.00	66.40		66.40
570	Casualty & Losss									
580	Pipeline Taxes	456.60	31,900.0	32,356.6	114.15		8,269.5	37.90		2,745.49
	TOTAL	$13,746.40	$106,325.0	$120,071.4	$ 3,436.60		$30,228.0	$ 1,140.95		$ 9,634.54
	OTHER									
650	Interest Exp.	$ 1,860.80	$114,500.0	$116,360.8	$ 465.20		$32,674.0	$ 154.45		$ 9,618.44
660	Prov. Removal & Res.		16,400.0	16,400.0			8,513.5			697.00
	TOTAL	$ 1,860.80	$141,725.0	$132,760.8	$ 465.20		$41,187.5	$ 154.45		$10,315.44
	GRAND TOTAL	$44,759.40			$11,199.85			$ 3,715.02		

Protest of the State of Alaska Seeking Suspension.

Schedule2
Page 3 of 3

DISTRIBUTION OF TOTAL TAPS 1978 ESTIMATED COSTS
AT 1.2 MILLION BARRELS PER DAY AMONG TAPS OWNERS
BASED ON SUBMISSIONS TO ICC
($000)
(CONTINUED)

Acct. No.	Account Designation	Alyeska Portion	Exxon Additional[7]	Total	Alyeska Portion
	OPERATIONS				
300	Sal. & Wages	$ 138.08		$ 138.0	$ 157.80
310	Suppl. & Exp.	88.77		89.0	98.24
320	Outside Serv.	82.07		82.0	90.82
330	Oper. Fuel & Power	427.92	$ 165.0	593.0	473.56
340	Oil L & S				
	Total	$ 736.84	$ 165.0	$ 902.8	$ 815.42
	MAINTENANCE				
400	Sal. & Wages	99.65			$ 110.27
410	Supply Exp.	58.76			65.02
420	Outside Serv.	1,161.27			1,285.14
430	Maint. Mat'ls.	129.92			143.77
	TOTAL	$1,449.60		$1,857.6	$1,604.20
	GENERAL				
500	Sal. & Wages	$ 268.46		$ 268.0	$ 297.09
510	Supp. & Exp.	101.37		101.0	112.18
520	Outside Serv.	364.55	$ 483.0	848.0	403.43
530	Rentals	109.99		110.0	121.73
540	Deprec. & Amort.		5,754.0	5,754.0	
550	Pensions & Ben.	92.37		92.0	102.22
560	Insurance	60.00	48.0	108.0	66.40
570	Casualty & Loss				
580	Pipeline Taxes	34.25		2,481.0	37.90
	TOTAL	$1,030.99		$9,962.0	$1,140.95
	OTHER				
650	Interest Exp.	$ 139.56	$11,288.0	$11,428.0	$ 154.45
660	Prov. Renewal & Res.		629.0	629.0	
	TOTAL	$ 139.56	$11,917.0	$12,057.0	$ 154.45
	GRAND TOTAL	$ 356.99			$ 3,715.02

[1]Not available.

[2]May 27, 1977 submission to ICC (letter by P. H. Jones).

[3]Not available.

[4]June 1, 1977 submission to ICC (letter by J. D. Sturtevant).

[5]April 29, 1977 submission to ICC (letter by C. R. Thompson).

[6]May 27, 1977 submission to ICC (letter by E. J. Takachi

[7]June 1, 1977 submission to ICC (letter by R. E. Stafford).

[8]Not available.

Protest of the State of Alaska Seeking Suspension.

Schedule 3

DISTRIBUTION OF ALYESKA ESTIMATED
REMOVAL & RESTORATION COSTS
($000)

	Distribution Of Annual Amount[1]
Sohio	$13,989
BP	6,646
ARCO	8,012
HESS	629
EXXON	8,392
MOBIL	2,098
UNION	697
PHILLIPS	697
TOTAL	$41,960[2]

[1]Distribution based on ownership percentages.

[2]$1,049,000 of Alyeska estimate (June 1, 1977 Exxon submission to ICC, letter by J. D. Sturtevant) divided by 25 years.

Protest of the State of Alaska Seeking Suspension.

Schedule 4

FEDERAL & STATE INCOME TAX FORMULAS

(1) Equity Return (ER) =	Net Income Before Taxes (NIBT) minus Income Taxes (IT)
(2) IT =	Federal Income Taxes (FIT) plus State Income Taxes (SIT)
(3) FIT =	.48 (NIBT-SIT)
(4) SIT =	.094 NIBT
(5) ER =	NIBT - .48(NIBT - .094 NIBT) - .094 NIBT
(6) ER =	.47112 NIBT
(7) NIBT =	2.1226 ER

Protest of the State of Alaska Seeking Suspension.

Schedule 5A

SOHIO
ESTIMATED TAPS TARIFF CALCULATION
($000)

Costs		Common Equity Returns 11%	13%	15%	26.4%
(1) Operating[1]	$ 23,892	→			
(2) Maintenance[2]	32,220	→			
(3) General[3]	77,399	→			
(4) Deprec. & Amt.[4]	128,141	→			
(5) Removal & Restoration[5]	13,989	→			
(6) Interest[6]	301,059				
(7) Sub-Total	$576,700	→			
(8) State Income Tax[7]	1,266	$ 1,496	$ 1,726	$ 30,349	
(9) Federal Income Tax[8]	5,855	6,921	7,984	140,405	
(10) Equity Return[9]	6,343	7,496	8,649	152,099	
(11) Total	$590,164	$592,613	$595,059	$899,545	
(12) Barrels Per Year[10]	146,030	→			
(13) Tariff (11)÷(12)	$4.04	$4.06	$4.08	$6.16	

[1] Sohio portion of Alyeska costs (Schedule 1) plus 1.67 of Exxon's additional costs (Schedule 2), 1.67 = 33.34% Sohio/20% Exxon.

[2] Schedule 1.

[3] Sohio portion of Alyeska costs (Schedule 1) excluding dep. & amt. but plus 1.67 of Exxon's additional costs (Schedule 2).

[4] Depreciation of $109,460 determined as 2.105 of BP's depreciation (Schedule 2) 2.105 = 33.34% Sohio/15.84% BP. Amortization of $18,681 estimates as follows:

Exxon's depr. & amt. (Sch.	771,700	*1.2626-
Less Exxon's est. depr. a		20% Exxon,
1.263* of BP's $52,000 d		15.84% BP
(Sch. 2)	65,657	
Est. Exxon Amort.	8,043	
Ratio of Sohio Weighted Debt costs to Exxon weighted debt costs (Sch. 5C)	2.3225	
Est. Sohio Amort.	$18,681	

[5] See Schedule 3.

[6] Determined as follows:

$128,141	Dep. & Amt.
x 25	years
$3,203,525	Investment in Plant
x .982	Debt Ratio
$3,145,862	Debt Capital
x .0957	Debt Cost
$301,059	Interest

[7] See Schedule 4.

[8] See Schedule 4.

[9] Determined as follows:

$3,203,525	Investment in Plant
x .018	Equity Ratio
57,663	Equity Capital
x k	Equity Cost
[illegible]	Equity Return

[10] Based on Sohio's share of 1.3 million barrels per day.

Protest of the State of Alaska Seeking Suspension.

Schedule 5B

SOHIO PIPE LINE
COST OF CAPITAL
1976

	Amount (000)	% Of Total	Annual Cost Rate %	Cost Factor	Wtd. Cost
Long Term Debt	$2,466,892[1]	91.8%	9.9%	9.09	
Short Term Debt	173,204	6.4	4.83	0.31	
Preferred Stock	0				
Common Equity	47,302	1.8			
Totals	$2,687,398	100.0%			
Common Equity ROR 11%		1.8	11.0	0.20	9.60
12%		1.8	12.0	0.22	9.62
13%		1.8	13.0	0.23	9.63
14%		1.8	14.0	0.25	9.65
15%		1.8	15.0	0.27	9.67

[1]This is the rate given by a weighted average of the long term rates for the year, as reported by the Company. Rates not reported and the respective amounts outstanding were omitted in the computation of this average.

Source: Annual Report of Sohio Pipe Line Co. to the ICC, 1976.

Protest of the State of Alaska Seeking Suspension.

Schedule 5C

RATIO FOR ESTIMATING AMORTIZATION
($000)

(1) Exxon Estimated Amortization	$8,043
(2) Exxon Ownership	.20
(3) Exxon Debt Ratio	.838
(4) Exxon Debt Cost	.0805
(5) Exxon Cost Weighting Factor (2)x(3)x(4)	.01349
(6) Sohio Ownership	.3334
(7) Sohio Debt Ratio	.982
(8) Sohio Debt Cost	.0957
(9) Sohio Cost Weighting Factor (6)x(7)x(8)	.03133
(10) Ratio (9)÷(5)	2.3225

Protest of the State of Alaska Seeking Suspension.

Schedule 6A

BP
ESTIMATED TAPS TARIFF CALCULATION

Costs	Common Equity Returns 11%	13%	15%	37.6%
(1) Operating[1]	$ 9,523	→		
(2) Maintenance[2]	15,308	→		
(3) General[3]	39,892	→		
(4) Deprec. & Amt.[4]	59,606	→		
(5) Removal & Restoration[5]	6,646	→		
(6) Interest[6]	120,015	→		
(7) Sub-Total	$250,990	→		
(8) State Income Tax[7]	5,210	6,158	7,105	17,820
(9) Federal Income Tax[8]	24,105	28,487	32,869	82,441
(10) Equity Return[9]	26,112	30,860	35,607	89,312
(11) Total	$306,417	$316,495	$326,571	$440,563
(12) Barrels Per Year[10]	69,380	→		
(13) Tariff (11)÷(12)	$4.42	$4.56	$4.71	$6.35

[1] BP operating costs from Schedule 2.

[2] BP maintenance costs from Schedule 2.

[3] BP costs (Schedule 2) less deprec. costs.

[4] Depreciation of $52,000 from Schedule 2.
Amortization of $7,606 estimated as follows:

Exxon dep. & amort. (Sch. 2)	$73,700
Less Exxon's est. deprec. at 1.26 of BP's $52,000 (Sch. 2)	65,657
Est. Exxon amort.	8,043
Ratio of BP weighted cost to Exxon's weighted debt costs (Sch. 6C)	.9457
	$7,606

[5] Schedule 3.

[6] Determined as follows:

$ 59,606	Debt and Amort.
x 25	Years
$1,490,150	Investment in Plant
x .8407	Debt Ratio
1,252,769	Debt Capital
x .0958	Debt Cost
120,015	Interest

[7] See Schedule 4.

[8] See Schedule 4.

[9] Determined as follows:

$1,490,150	Investment in Plant.
x .1593	Equity Ratio
237,381	Equity Capital
x k	Equity Cost
ER	

[10] Based on BP's share of 1.2 million

NOTE: Totals may not add due to rounding.

Protest of the State of Alaska Seeking Suspension.

Schedule 6B

BP PIPE LINES, INC.
COST OF CAPITAL
12/31/76

	Amount (000)	% Of Total	Annual Cost Rate %	Cost Factor	Wtd. Cost
Long Term Debt	$ 866,824	73.89%	10.21%	7.54	
Short Term Debt[1]	119,459	10.18	5.05[2]	0.51	
Common Equity	186,793	15.93			
Totals	$1,173,076	100.0%			
Common Equity ROR 11%		15.93	11.00	1.75	9.80
12%		15.93	12.00	1.91	9.96
13%		15.93	13.00	2.07	10.12
14%		15.93	14.00	2.23	10.28
15%		15.93	15.00	2.39	10.44

[1] Commercial Paper Only.

[2] Note E to the Balance Sheet.

Source: 1976 Form 10K (SEC) of the Company.

Protest of the State of Alaska Seeking Suspension.

Schedule 6C

RATIO FOR ESTIMATING AMORTIZATION
($000)

(1)	Exxon Estimated Amortization	$8,043
(2)	Exxon Ownership	.20
(3)	Exxon Debt Ratio	.838
(4)	Exxon Debt Cost	.0805
(5)	Exxon Cost Weighting Factor (2)x(3)x(4)	.01349
(6)	BP Ownership	.1584
(7)	BP Debt Ratio	.8407
(8)	BP Debt Cost	.0958
(9)	BP Cost Weighting Factor (6)x(7)x(8)	.01276
(10)	Ratio (9)÷(5)	.9457

Protest of the State of Alaska Seeking Suspension.

Schedule 7A

ARCO
ESTIMATED TAPS TARIFF CALCULATION

Costs	Common Equity Returns 11%	13%	15%	66.0%
(1) Operating[1]	$ 15,041	→	→	→
(2) Maintenance[2]	20,294	→	→	→
(3) General[3]	48,690	→	→	→
(4) Deprec. & Amt.[4]	77,453	→	→	→
(5) Removal & Restoration[5]	8,812	→	→	→
(6) Interest[6]	131,470	→	→	→
(7) Sub-Total	$301,760	→	→	→
(8) State Income Tax[7]	3,974	4,696	5,418	23,858
(9) Federal Income Tax[8]	18,384	21,727	25,069	110,377
(10) Equity Return[9]	19,915	23,536	27,157	119,570
(11) Total	$344,033	$351,719	$359,404	$555,559
(12) Barrels Per Year[10]	91,980	→	→	→
(13) Tariff (11)÷(12)	$3.74	$3.82	$3.91	$6.04

[1] Arco portion of Alyeska costs (Sch. 1) plus 1.05 of Exxon's add't. costs (Sch. 2), 1.05 = 21% Arco/20% Exxon.

[2] Schedule 1.

[3] Arco portion of Alyeska costs (Sch. 1) excluding dep. & amort. but plus 1.05 of Exxon's add't. costs (Sch. 2).

[4] Deprec. of $68,952 determined as 1.326 of BP's deprec. (Sch. 2), 1.326 = 21% Arco/15.84% BP.
Amortization of $8501 est. as follows:

Exxon dep. and amort. (Sch. 2)	$73,700
Less Exxon's est. deprec. at 1.2626 of BP's $52,000 deprec. (Sch. 2)	65,657
Est. Exxon Amort.	8,043
Ratio of Arco weighted debt cost to Exxon's weighted debt costs (Sch. 7C)	1.057
	$8,501

[5] See Schedule 3.

[6] Determined as follows:

$ 77,453	Dep. & Amort.
x 25	Years
$1,936,325	Investment in Plant
x .9065	Debt Ratio
1,755,279	Debt Capital
x .0749	Debt Cost
$ 131,470	

[7] See Schedule 4.

[8] See Schedule 4.

[9] Determined as follows:

$1,936,325	Investment in Plant
x .0935	Equity Ratio
181,047	Equity Capital
x k	
ER	

[10] Based on ARCO's share of 1.2 million barrels per day.

Protest of the State of Alaska Seeking Suspension.

Schedule 7B

ARCO PIPELINE
COST OF CAPITAL
12/31/76

	Amount (000)	% Of Total	Annual Cost Rate %	Cost Factor	Wtd. Cost
Long Term Debt	$1,286,947	75.85%	8.05%	6.11	
Short Term Debt	251,037[1]	14.80	4.59	0.68	
Common Equity	158,779	9.35			
Totals	$1,696,763	100.00%			
Common Equity ROR 11%		9.35	11.00	1.03	7.82
12%		9.35	12.00	1.12	7.91
13%		9.35	13.00	1.22	8.01
14%		9.35	14.00	1.31	8.10
15%		9.35	15.00	1.40	8.19

[1]This figure includes unamortized debt discounts, as reported by Company, p. 6 of 12K, 1976.

Source: Form 10K of the Company, 1976.

Protest of the State of Alaska Seeking Suspension.

Schedule 7C

RATIO FOR ESTIMATING AMORTIZATION
($000)

(1) Exxon Estimated Amortization	$8,043
(2) Exxon Ownership	.20
(3) Exxon Debt Ratio	.838
(4) Exxon Debt Cost	.0805
(5) Exxon Cost Weighting Factor (2)x(3)x(4)	.01349
(6) ARCO Ownership	.21
(7) ARCO Debt Ratio	.9065
(8) ARCO Debt Cost	.0749
(9) ARCO Cost Weighting Factor (6)x(7)x(8)	.0143
(10) Ratio (9)÷(5)	1.057

Protest of the State of Alaska Seeking Suspension.

Schedule 8A

EXXON
ESTIMATED TAPS TARIFF CALCULATION

Costs	Common Equity Returns 11%	13%	15%	62.2%
(1) Operating[1]	$ 14,324 →			
(2) Maintenance[2]	19,328 →			
(3) General[3]	46,371 →			
(4) Deprec. & Amt.[4]	73,700 →			
(5) Removal & Restoration[5]	8,392 →			
(6) Interest[6]	124,293 →			
(7) Sub-Total	$286,408 →			
(8) State Income Tax[7]	4,368	5,162	5,956	24,707
(9) Federal Income Tax[8]	20,206	23,880	27,554	114,306
(10) Equity Return[9]	21,889	25,869	29,849	123,631
(11) Total	$332,871	$341,319	$349,767	$549,252
(12) Barrels Per Year[10]	87,600 →			
(13) Tariff (11)÷(12)	$3.80	$3.90	$3.99	$6.27

[1] Exxon operating costs, Schedule 2.

[2] Exxon maintenance costs, Schedule 2.

[3] Exxon costs (Schedule 2) less deprec. and amort.

[4] Exxon deprec. and amort. costs (Sch. 2).

[5] See Schedule 3.

[6] Determined as follows:
$ 73,700 Dep. & Amort.
x 25 Years
$1,842,500 Investment in Plant
x .838 Debt Ratio
1,544,015 Debt Capital
x .0805 Debt Cost
$ 124,293 Interest

[7] See Schedule 4.

[8] See Schedule 4.

[9] Determined as follows:
$1,842,500 Investment in Plant
x .108 Equity Ratio
198,990 Equity Capital
x k
ER

[10] Based on Exxon's share of 1.2 million barrels per day.

NOTE: Totals may not add due to rounding.

Protest of the State of Alaska Seeking Suspension.

Schedule 8B

EXXON PIPELINE
COST OF CAPITAL
1976

	Amount (000)	% Of Total	Annual Cost Rate %	Cost Factor	Wtd. Cost
Long Term Debt	$1,355,327[1]	79.1%	8.25[2]%	6.53	
Short Term Debt	81,050	4.7	4.7	0.22	
Preferred Stock	0		0	0	
Deferred Tax Credits	92,441	5.4	0	0	
Common Equity	184,586	10.8			
Totals	$1,713,404	100.0%			
Common Equity ROR 11%		10.8	11.0	1.19	7.94
12%		10.8	12.0	1.30	8.03
13%		10.8	13.0	1.40	8.15
14%		10.8	14.0	1.51	8.20
15%		10.8	15.0	1.62	8.37

[1] Includes long term debt due within one year.

[2] The rate given by a weighted average of the rates paid for the year, as reported by the Company in source noted below.

Source: 1976 Annual Report, Form P, of Company to Interstate Commerce Commission.

Protest of the State of Alaska Seeking Suspension.

Schedule 9A

MOBIL
ESTIMATED TAPS TARIFF CALCULATION

Costs		Common Equity Returns 11%	13%	15%	J
(1) Operating[1]	$ 2,719	→			
(2) Maintenance[2]	4,832	→			
(3) General[3]	12,148	→			
(4) Deprec. & Amt.[4]	18,823	→			
(5) Removal & Restoration[5]	2,098	→			
(6) Interest[6]	38,022	→			
(7) Sub-Total	$ 78,642	→			
(8) State Income Tax[7]					$ 5,598
(9) Federal Income Tax[8]					25,896
(10) Equity Return[9]					28,055[11]
(11) Total	$ 78,642	→			138,189
(12) Barrels Per Year[10]	21,900	→			
(13) Tariff (11)÷(12)	$3.59	→			$6.31

[1] Mobil operating costs from Sch. 2.

[2] Mobil maint. costs from Sch. 2.

[3] Mobil costs Sch. 2 less deprec. costs.

[4] Deprec. of $16,414*
Amort. of $2409 est. as follows:

Exxon dep. & amort. (Sch. 2)	$73,700
Less Exxon est. at 1.26 of BP's $52,000 (Sch. 2)	65,657
Estimated Exxon amort.	[illegible]
Ratio of Mobil weighted debt cost to Exxon's weighted debt cost (Sch. 9C)	.895
	$ 2,409

[5] See Schedule 3.

[6] Determined as follows:
$18,823 Depr. and Amort.
x 25 Years
$470,575 Debt Capital
x .0808 Debt Cost
$38,022 Interest

[7] Not applicable.

[8] Not applicable.

[9] No equity, see Schedule 9B.

[10] Based on Mobil's share of 1.2 million barrels per day.

[11] Profit.

*Calculated as $16,414 = $52,000 (BP's deprec.) x (.316); 5% Mobil/15.84% BP = .316

Protest of the State of Alaska Seeking Suspension.

Schedule 9B

MOBIL ALASKA PIPE LINE CO.
COST OF CAPITAL
1976

		Amount (000)	% Of Total	Annual Cost Rate %	Cost Factor	Wtd. Cost
Long Term Debt		$300,000	90.5%	8.45%[1]	7.65	
Short Term Debt		31,622	9.5	4.525[2]	0.43	
Preferred Stock		0				
Deferred Taxes		0				
Common Equity		000[3]				
Totals		$331,622	100.0%			
Common Equity ROR	11%		0.00	11.0	0.00	8.08
	12%		0.00	12.0	0.00	8.08
	13%		0.00	13.0	0.00	8.08
	14%		0.00	14.0	0.00	8.08
	15%		0.00	15.0	0.00	8.08

[1] Rate reported in Form 10K, Mobil Company, 1976, p. D-5.

[2] Midpoint of 4.375 - 4.675% paid for short term debt as reported in Form 10K, Mobil Corp., 1976, p. D-5.

[3] Actual figure is shown as negative $3,888,000 on Balance Sheet of Mobil Alaska Pipeline Co., as reported in Form 10K, Mobil Corp., 1976, P. D-8.

Source: Form 10K of Mobil Corp. 1976.

Schedule 9C

RATIO FOR ESTIMATING AMORTIZATION
($000)

(1) Exxon Estimated Amortization	$8,043
(2) Exxon Ownership	.20
(3) Exxon Debt Ratio	.838
(4) Exxon Debt Cost	.0805
(5) Exxon Cost Weighting Factor (2)x(3)x(4)	.01349
(6) Mobil Ownership	.05
(7) Mobil Debt Ratio	1.00
(8) Mobil Debt Cost	.0808
(9) Mobil Cost Weighting Factor (6)x(7)x(8)	.00404
10) Ratio (9)÷(5)	.2995

Schedule 10

CONSOLIDATED EMBEDDED
COST OF DEBT
TRANS ALASKA PIPELINE
1976

Pipeline Company	% Of Total Ownership	Annual Cost Rate	Cost Factor
SOHIO	33.34%	9.57%	3.19
BP	15.84	9.58	1.52
ARCO	21.00	7.49	1.57
EXXON	20.00	8.05	1.61
MOBIL	5.00	8.08	0.40
Others[1]	4.82	8.55	0.41
Totals	100.00%		8.70

[1]The 4.82% portion of ownership not owned by the above five companies was figured at the average embedded cost of the five for which data were available.

Protest of the State of Alaska Seeking Suspension.

Schedule 11

ESTIMATE OF CONSOLIDATED TAPS TARIFF
AT RETURNS OF 13 AND 14 PERCENT ON RATE BASE

Costs	Rates of Return 13%	14%
(1) Total Operating[1]	$ 377,618	$ 377,618
(2) Deprec. & Amt.	368,500	368,500
(3) Removal & Restoration[3]	41,960	41,960
(4) Interest[4]	681,264	681,264
(5) Sub-Total	$1,469,342	$1,469,342
(6) State Income Tax[5]	103,026	121,408
(7) Federal Income Tax[6]	476,641	561,679
(8) Equity Return[7]	516,361	608,486
(9) Total	$2,565,370	$2,760,915
(10) Barrels Per Year[8]	438,000	438,000
(11) Tariff (9)÷(10)	$5.86	$6.30

[1] Alyeska costs (Sch. 1) plus 5 times Exxon's add't. costs (not including deprec. and amort.), Sch. 2.

[2] Based on Exxon's deprec. and amort. of $73,700. ($73,700)÷(20%)=$368,500

[3] See Schedule 3.

[4] Determined as follows:

$ 73,700	Exxon deprec. and amort.
x 5	
368,500	Total Annual
x 25	Years
$9,212,500	TAPS rate base (RB)
x .85	Debt ratio (assumed)
$7,830,625	Debt Capital
x .087	See Sch. 10
$ 681,264	Interest Cost

[5] See Schedule 4.

[6] See Schedule 4.

[7] Determined as follows:

$9,212,500	RB
x .13	Rate of Return
$1,197,625	ER & Interest Costs
- 681,264	Interest Cost
$ 516,361	ER
$9,212,500	RB
x .14	Rate of Return
$1,289,750	ER & Interest Costs
- 681,264	Interest Cost
$ 608,486	ER

[8] Annual throughput at 1.2 million barrels per day.

Protest of the State of Alaska Seeking Suspension.

Schedule 12

DISTRIBUTION OF TAPS COSTS (¢/B)
AT 11 PERCENT RETURN ON EQUITY

	Sohio	BP	Arco	Exxon	Mobil
Operating	16.36¢	13.73¢	16.35¢	16.35¢	12.42¢
Maintenance	22.06	22.06	22.06	22.06	22.06
General	53.00	57.50	52.94	52.93	55.47
Deprec. & Amt.	87.75	85.91	84.21	84.13	85.95
Removal & Rest.	9.58	9.58	9.58	9.58	9.58
Interest	206.16	172.98	142.93	141.89	173.62
Sub Total	394.92	361.76	328.07	326.95	359.10
State Income Tax	.87	7.51	4.32	4.99	0
Federal Income Tax	4.01	34.74	19.99	23.07	0
Equity Return	4.34	37.64	21.65	24.99	0
Total	404.14¢	441.65¢	374.03¢	379.99¢	359.10¢

Protest of the State of Alaska Seeking Suspension.

VERIFICATION

MICHAEL J. ILEO, being duly sworn, deposes and says that he has read the foregoing statement, knows the contents thereof, and that the same are true as stated.

MICHAEL J. ILEO

Michael J. Ileo

Subscribed and sworn to before me this day of June, 1977.

[illegible]

Notary Public

My Commission Expires:
February 10,1978

Preliminary Statement of Special Counsel, Alaska Pipeline Commission in Response to Request of the State of Alaska, June 15, 1977.

PRELIMINARY STATEMENT OF TERRY F. LENZNER, SPECIAL COUNSEL, ALASKA PIPELINE COMMISSION IN RESPONSE TO REQUEST OF THE STATE OF ALASKA

Introduction

On November 22, 1976, the Alaska Pipeline Commission initiated an investigation into the costs associated with the design and construction of the Trans-Alaska Pipeline Systems (hereinafter "TAPS"). The Alaska Pipeline Commission has a two-fold interest in the costs of construction and design of TAPS. First, the Commission regulates the tariffs charged for the intrastate transportation of oil in the TAPS system and the design and construction costs are an important component of those tariffs. Second, the Commission is statutorially required to assist the Attorney General of the State of Alaska in intervening on behalf of the State of Alaska at Interstate Commerce Commission proceedings regarding the interstate tariff for TAPS. The cost of TAPS design and construction is an important component of the interstate tariff, and the level of this tariff affects the tax and royalty interest revenues which the State obtains from the production of North Slope oil.

To act as its Special Counsel in conducting the investigation, the Commission retained Terry F. Lenzner, a member of the Washington, D.C. law firm of Wald, Harkrader & Ross. The Alaska Pipeline Commission also retained the services of several independent consultants to assist the Special Counsel, including the following individuals and organizations:

1. *Dr. Robert Lind*: Professor, Graduate School of Business and Public Administration and Director, Energy Policy Studies Unit, Cornell University; Ithaca, New York.

2. *Aerospace Corporation*: Engineering and Economic consultants with extensive experience in Alaskan transportation, energy, and environmental matters; Los Angeles, California.

3. *VHS Associates*: Consultants in cost estimating and construction management of pipelines, terminals and comparable facilities; San Rafael, California.

4. *Resource Planning Associates*: Economic and management consultants with extensive experience in issues relating to the oil and gas industry; Cambridge, Massachusetts.

In the course of the TAPS investigation, considerable information has been obtained and analyzed. The sources of information include interviews of individuals presently or formerly connected with the TAPS construction effort and thousands of documents in the public domain or otherwise made available to the Special Counsel's staff which relate to the TAPS project. However, the evidence uncovered by the investigation to date makes clear that much information necessary to a complete analysis of the TAPS project is within the exclusive possession of the TAPS owner companies (both the pipeline companies, their corporate parents, and their affiliates) and their construction agent, Alyeska Pipeline Service Company (hereinafter "Alyeska").

Of the documents provided by Alyeska, some have had data deleted. Likewise, Alyeska has frustrated our efforts

to interview present and former Alyeska employees and employees of various Alyeska contractors.[1] Several of Alyeska's contractors, including Bechtel, Incorporated (hereinafter "Bechtel"), have proven equally uncooperative.

Through the use of compulsory process, we have been able to compel Alyeska to make available some information about TAPS. However, legal efforts to resist such process, while unsuccessful on the merits, have delayed completion of the Alaska Pipeline Commission's investigation, and denied our office a complete record of the TAPS construction effort.

Despite the foregoing obstacles and constraints, the Alaska Pipeline Commission's investigation has made substantial progress and has developed sufficient evidence to permit preliminary conclusions to be made at this time. Pursuant to the request of the Attorney General of the State of Alaska, the following paragraphs present, for the consideration of the Interstate Commerce Commission, a summary of the evidence which has been derived to date in connection with the Alaska 'Pipeline Commission's investigation. This evidence, in the Special Counsel's view, reveals a project characterized by an unnecessary duplication of management structure and responsibility, ineffective utilization of labor and equipment, an inexcusable absence of effective cost control procedures and incentives or other evidence of concern about excessive costs, a refusal to authorize adequate planning and design prior to construc-

1. Alyeska's tactics have either taken the form of outright interview refusals or of the imposition of unreasonable conditions on interview procedures. For example, Alyeska has prevented its contractors or its former employees from talking with the Special Counsel unless Alyeska representatives are present. In light of the obvious .opportunities for collusion or intimidation inherent in that procedure, the Special Counsel has declined to proceed in this manner.

tion, and an inexplicable failure to establish information and cost control systems essential for an efficient construction effort.

Under these circumstances, it is hardly surprising that the TAPS construction project has been plagued by monumental cost overruns. Originally projected to cost less than $900 million, the final construction cost estimates escalated to $3.5 billion in early 1974, to $6.4 billion in 1975 and to today's projection of $8 billion (without capitalized interest costs). While some of the ten-fold increase can be attributed to factors beyond the control of the TAPS owner companies and their agents, it seems clear that hundreds of millions of dollars were wasted as a result of mismanagement and an organizational lack of concern about economy or efficiency.

To document this conclusion, the evidence must be categorized and reviewed in detail. In this regard, however, two caveats must be kept in mind. First, because a "cost-plus" mentality appears to have pervaded nearly every aspect of the project, many excessive costs were incurred in a manner rendering them difficult to verify or to quantify. Nevertheless, such verification/quantification has been undertaken and will be reflected in the final report of the Special Counsel to the Alaska Pipeline Commission. Second, while it is necessary to categorize the evidence, a construction project consists of many parts which are intricately interrelated. Thus, every imprudent decision had not only a primary impact upon project costs, but also numerous "ripple" effects beyond a given cost category which each contributed to the sum of excessive expenditures. With these caveats in mind, we have organized the evidence derived by the investigation. The following paragraphs

summarize the evidence analyzed to date which relate to these subject areas:

I. Overall TAPS Organization and Structure
II. Construction Budget and Cost Controls
III. Construction Equipment, Spare Parts and Inventory Control
IV. Labor Productivity
V. Support Services
VI. Aboveground Design and Construction
VII. Welding
VIII. River Crossings
IX. Section 5.
X. Valdez Terminal

Protest of United Sates Department of Justice for Suspension of Tariffs for Transportation of Liquid Hydrocarbons and Gas from Prudhoe Bay to Valdez Marine Terminal, June 15, 1977.

[caption omitted in printing]

BEFORE THE
INTERSTATE COMMERCE COMMISSION

PROTEST AND PETITION FOR SUSPENSION BY THE UNITED STATES DEPARTMENT OF JUSTICE

TARIFFS

(1)	Effective Date:	June 20, 1977.*
	Tariff Reference:	Page 1 to Tariff ICC No. 2 issued by BP Pipelines Incorporated.
	Commodity:	Petroleum (unrefined liquid hydrocarbons including gas liquids).
	Territory:	From: Prudhoe Bay, Alaska. To: Valdez Marine Terminal, Alaska.
(2)	Effective Date:	June 20, 1977.*
	Tariff Reference:	Page 1 to Tariff ICC No. 742 issued by Sohio Pipe Line Company.
	Commodity:	Petroleum (unrefined liquid hydrocarbons including gas liquids).
	Territory:	From: Prudhoe Bay, Alaska. To: Valdez Marine Terminal, Alaska.

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* On June 13, 1977, the Special Permission Board of the Commission approved the application of BP Pipelines Incorporated, Sohio Pipe Line Company and Mobil Alaska Pipeline Company for leave to file supplements to their tariffs to postpone the effective date of their tariffs from June 20, 1977 to June 30, 1977.

Protest of U. S. Department of Justice.

(3)	Effective Date:	June 20, 1977.*
	Tariff Reference:	Page 1 to Tariff ICC No. 2 issued by Mobil Alaska Pipeline Company.
	Commodity:	Petroleum (unrefined liquid hydrocarbons including gas liquids).
	Territory:	From: Prudhoe Bay, Alaska. To: Valdez Marine Terminal, Alaska.
(4,	Effective Date:	June 30, 1977.
	Tariff Reference:	Page 14 to Tariff ICC No. 1030 issued by Arco Pipe Line Company.
	Commodity:	Petroleum (unrefined liquid hydrocarbons including gas liquids).
	Territory:	From: Prudhoe Bay, Alaska. To: Valdez Marine Terminal, Alaska.
(5)	Effective Date:	July 1, 1977.
	Tariff Reference:	Page 2 to Tariff ICC No. 2 issued by Amerada Hess Pipeline Corporation.
	Commodity:	Petroleum (unrefined liquid hydrocarbons including gas liquids).
	Territory:	From: Prudhoe Bay, Alaska. To: Valdez Marine Terminal, Alaska.

(6)	Effective Date:	June 30, 1977.
	Tariff Reference:	Page 2 to Tariff ICC No. 125 issued by Exxon Pipeline Company.
	Commodity:	Petroleum (unrefined liquid hydrocarbons including gas liquids).
	Territory:	From: Prudhoe Bay, Alaska. To: Valdez Marine Terminal, Alaska.
(7)	Effective Date:	June 30, 1977.
	Tariff Reference:	Page 2 to Tariff ICC No. 2 issued by Union Alaska Pipeline Company.
	Commodity:	Petroleum (unrefined liquid hydrocarbons including gas liquids).
	Territory:	From: Prudhoe Bay, Alaska. To: Valdez Marine Terminal, Alaska.

PROTEST AND PETITION FOR SUSPENSION

Pursuant to Section 15(7) of the Interstate Commerce Act (hereinafter "the Act"), 49 U.S.C. § 15(7), and Rule 42 of the Rules of Practice of the Interstate Commerce Commission, 15 C.F.R. § 1100.42, the Department of Justice ("Department") respectfully submits this petition for the suspension of the rates as set forth below which were published in the above-referenced tariffs, without prejudice to the filing carriers to file new rates on one day's notice, and for an investigation into the lawfulness of such rates:

(1)	BP Pipelines Incorporated	$6.35
(2)	Sohio Pipe Line Company	$6.16
(3)	Arco Pipe Line Company	$6.04
(4)	Amerada Hess Pipeline Company	$6.44
(5)	Exxon Pipeline Company	$6.27
(6)	Mobil Alaska Pipeline Company	$6.31
(7)	Union Alaska Pipeline Company	$6.09

In support of its petition, the Department respectfully alleges as follows:

I

This protest is directed at the initial tariff rates for the transportation of unrefined liquid hydrocarbons, including gas liquids, from Prudhoe Bay, Alaska, to Valdez Marine Terminal, Alaska, filed by the following carriers: BP Pipelines Incorporated (hereinafter "BP"), effective date June 20, 1977; Sohio Pipe Line Company (hereinafter "Sohio"), effective date June 20, 1977; Mobil Alaska Pipeline Company (hereinafter "Mobil"), effective date June 20, 1977; Arco Pipe Line Company (hereinafter "Arco"), effective date June 30, 1977; Amerada Hess Pipeline Company (hereinafter "Hess"), effective date July 1, 1977; Exxon Pipeline Company (hereinafter "Exxon"), effective date June 30, 1977; and Union Alaska Pipeline Company (hereinafter "Union"), effective June 30, 1977. Each of the foregoing carriers holds an ownership interest in the Trans-Alaska Pipeline System (hereinafter "TAPS").

II

The above described rates are unreasonably high in violation of Section 1(5) of the Act, 49 U.S.C. § 1(5), and are inconsistent with the National Transportation Policy, 49 U.S.C. preceding, § 1 (54 Stat. 899 (1940)), of encouraging

maximum output through the most efficient means of transportation, at reasonable cost.

III

Table I of attached Exhibit 1, incorporated herein, shows that the initial rates filed by BP, Sohio, Mobil, Arco, Hess, Exxon and Union produce excessive returns on the carriers' equity investments in the pipeline. These data are based upon information in the public record and submissions by the companies to the Commission.[1] Because there is no available information as to the average interest rate on debt or the proportions of debt and equity which apply to the investments of each carrier, with the exception of Sohio and Union,[2] equity return calculations were performed for three debt/equity percentage ratios: 80/20, 85/15 and 90/10, based upon actual total debt costs submitted by the carriers.[3] Conceding, for the purpose of this suspension

1. These submissions are contained in the following letters to the Commission: BP—May 27, 1977; Sohio—June 13 and 14, 1977; Arco—June 1, 1977; Hess—May 13 and June 1, 1977; Exxon—June 1, 1977; Mobil—May 27, 1977; and Union—May 27 and June 14, 1977.

2. In its letter to the Commission of June 13, 1977 Sohio stated that its debt/equity percentage ratio is 86/14 and its average interest rate on debt is 9.3%. Union's debt/equity percentage ratio is 89/11 and its average interest rate on debt is 7.5%. These figures are derived from the letters to the Commission of May 27 and June 14, 1977.

3. The data sources relied upon for each element of this calculation and the basis for certain assumptions made (necessitated by gaps in the information supplied by the carriers) are specified in Exhibit 1. Some of the assumptions made are based upon a study prepared under contract to the Federal Energy Administration by Mortada International, "The Determination of Equitable Pricing Levels for North Slope Alaskan Crude Oil" (Nov. 1976) (hereinafter "Mortada"). For instance, the study utilizes a capitalization of 85% debt/15% equity. *Id.* at I-2. Varying capitalizations were employed to demonstrate the effect of differing debt/equity mixes on return to equity and required tariff rates.

proceeding only, the accuracy and validity of the costs and procedures used by the carriers to determine their rates, the filed rates would result in the following returns to carrier equity:

Carrier	Debt/Equity Ratio		
	80/20	85/15	90/10
BP	31.2%	41.6%	62.3%
Sohio		39.4%[4]	
Arco	29.3%	39.0%	58.6%
Hess	31.9%	42.4%	63.7%
Exxon	39.2%	45.6%	68.4%
Mobil	21.07%	41.3%	62.0%
Union			65.2%[5]

IV

If, for the purposes of this suspension proceeding only, each carrier is permitted to earn a rate of return on equity of 14%[6] and the costs as claimed by the carriers are fully

4. Sohio's return to equity was calculated on the basis of an 86/14 debt/equity percentage ratio, derived from information supplied by the carrier. *See* note 1, p. 3, ***supra***.

5. Union's return to equity was calculated on the basis of an 89/11 debt/equity percentage ratio, derived from information supplied by the carrier. *See* note 1, p. 3, ***supra***.

6. The Department does not adopt a 14% return to equity as reasonable, nor does it adopt the costs, supplied by the carriers, relied upon as reasonably incurred. The Department reserves the right to offer further evidence on return to equity and to question any and all costs incurred or claimed in any further proceedings. The 14% return to equity was chosen based upon a recent Federal Power Commission natural gas pipeline case which found a 13.5% return to equity reasonable, and a recent Federal Communications Commission case which found a 12% return to equity reasonable for AT&T. Natural Gas Pipeline Co. of America, F.P.C. Docket No. RP-74-96, Opinion No. 762A (December 6, 1976); In the matter of American Telephone & Telegraph Co., 57 F.C.C. 2d 960, 972 (1976). Recently, in *Petroleum Products, Williams Brothers Pipe Line Co.*, the Commission found reasonable an independent pipeline company's rates, which resulted in a 14% return to equity. Initial Decision, at 21 (June 6, 1974) *aff'd* 353 I.C.C. (Dec. 21, 1976).

allowed, including interest on indebtedness, without questioning their accuracy and validity, the proposed rates should not exceed the following amounts depending upon individual carrier debt/equity ratios:

Carrier	Debt/Equity Ratio		
	80/20	85/15	90/10
BP	$4.83	$4.53	$4.23
Sohio		$4.54[7]	
Arco	$4.59	$4.40	$4.10
Hess	$4.88	$4.58	$4.27
Exxon	$4.49	$4.19	$3.88
Mobil	$4.83	$4.53	$4.22
Union			$3.74[8]

In Exhibit II the calculations used to determine per barrel rates required to produce sufficient total revenue to yield such a 14% return to equity for each filing carrier are set forth. Separate computations were performed for debt/equity ratios of 80/20, 85/15 and 90/10 utilizing actual carrier reported debt costs. Other costs were derived from submissions by the carriers themselves and information in the public record.

V

Based upon the above described calculations, and again conceding, for the purpose of this suspension proceeding

7. The maximum permissible tariff for Sohio was calculated based on a debt/equity percentage ratio of 86/14 and an average cost of debt of 9.3%, derived from information supplied by the carrier. *See* note 1, p. 3, *supra.*

8. The maximum permissible tariff for Union was calculated based on a debt/equity percentage ratio of 89/11 and an average cost of debt of 7.5%, derived from information supplied by the carrier. *See* note 1, p. 3, *supra.*

only, the accuracy and validity of the cost figures supplied by the carriers themselves, the initial rates filed by the carriers contain overcharges in the following range, depending on specific capitalizations:

BP	$1.52-$2.12
Sohio	$1.62[9]
Arco	$1.45-$1.94
Hess	$1.56-$2.17
Exxon	$1.78-$2.39
Mobil	$1.48-$2.09
Union	$2.35[10]

Such overcharges would result in a total overpayment for TAPS crude oil transportation of $700-900 million annually.

VI

Unreasonably high transportation rates restrict output and prevent the realization of cost savings derived from the large economies of scale associated with pipelines. Unreasonably high transportation rates also discourage exploration and development of new fields by reducing the wellhead value of crude, thereby decreasing returns on production. It would be inconsistent with national energy policy to permit rates to go into effect, such as those proposed by the carriers, which would unnecessarily impair the discovery and exploration of new sources of crude oil.

VII

Rate of return regulation should be designed to produce tariffs that hold the allowed return to capital close to a

9. *See* note 7, p. 5, *supra.*

10. *See* note 8, p. 5, *sdpra.*

competitive level, yet are sufficient to attract capital and maintain a satisfactory level of service. These goals were recognized by Congress in adopting the National Transportation Policy, pursuant to which the Commission must, in carrying out its responsibilities under the Act to regulate interstate crude oil pipelines:

> . . . recognize and preserve the inherent advantages of each [mode of transportation]; . . . promote safe, adequate, economical, and efficient service and foster sound economic conditions in transportation and among the several carriers; . . . [and] encourage the establishment and maintenance of reasonable charges for transportation services, without unjust discriminations [or] undue preferences or advantages[11] . . . .

VIII

The rate levels set forth in Paragraph IV above would compensate the carriers for their actual costs of providing pipeline transportation service, including all debt expenses, based on their own estimates of those costs, allow a generous return to their actual equity invested in the line, and promote safe, adequate, economical and efficient transportation of this critical energy source. Indeed, the requested full investigation may ultimately show that even these rate levels would yield excess returns.

IX

As the foregoing analysis demonstrates, the initial rates for the transportation of petroleum through TAPS are greatly in excess of the amount required to generate

11. 49 U.S.C., preceding §1, 54 Stat. 899 (1940).

revenue sufficient to attract capital and maintain a proper level of service.[12] This showing exceeds that required of protestants by the Act and by the Supreme Court in suspension proceedings contesting new or initial rates. Section 15 (7) of the Act (49 U.S.C. § 15(7)) provides that at any hearing the burden of proof is on the carrier to show that the proposed rate is just and reasonable. The Supreme Court has interpreted Section 15(7) to mean that when a proposed rate is challenged before it goes into effect, the carrier must establish that the rate meets statutory standards.[13] As the Supreme Court stated in *Atchison Topeka & Santa Fe Ry. Co.* v. *Wichita Board of Trade*:

> [Congress] specified the allocation of the burden of proof in suspension proceedings as part of the cost to carriers; in return for confining the power to suspend rates to the Commission . . . Congress made the carriers carry a burden that otherwise would not have been theirs.[14]

Thus, the Commission ought to suspend the rates under protest herein, unless the carriers can convincingly show that they do not exceed an amount consistent with the regulatory goal of encouraging maximum output through the most efficient means of transportation at reasonable cost, and that they do not exceed a level necessary to attract capital and maintain a proper level of service.

12. *See* note 6, p. 4, *supra.*

13. Atchison, T. & S.F., Ry. Co. v. United States, 279 U.S. 768 (1929); Baltimore & O. C. T. R. Co. v. United States, 279 F. Supp. 270 (D. Ill.), *aff'd*, 389 U.S. 88 (1967); Chicago E. I. R. Co. v. United States, 107 F. Supp. 118 (D. Ind. 1950), *aff'd*, 344 U.S. 917 (1953).

14. 412 U.S. 800, 814 (1973).

X

The rates under protest herein should be suspended without prejudice to the carriers to file new rates, not exceeding those set forth in Paragraph IV above, after each carrier has informed the Commission of the debt/equity percentage ratio of its interest in TAPS. In light of the substantial public interest in assuring that the energy needs of the nation are met in the most efficient and reasonably priced manner possible, and in recognition of the importance of TAPS in meeting that goal, a thoroughgoing investigation should be undertaken to determine a reasonable level of rates for the transportation of petroleum through TAPS. Such investigation should include the methodology of determining the rate of return, the appropriate rate of return to be allowed, and the reasonableness of the costs incurred or claimed.

XI

Wherefore, the Department of Justice respectfully requests the Commission to suspend the above described rates as published in the referenced tariffs, without prejudice to the carriers' rights to file rates revised in accordance with those set forth in Paragraph IV above, on one day's notice. The Department further requests the Commission to institute an investigation into the lawfulness of such rates, such investigation to include an analysis of

ratemaking methodology, allowed rate of return, and the reasonableness of costs incurred or claimed.

Respectfully submitted,

JOHN H. SHENEFIELD
John H. Shenefield
Acting Assistant
Attorney General
Antitrust Division

JOE SIMS
Joe Sims
Deputy Assistant Attorney
General
Antitrust Division

DONALD L. FLEXNER
Donald L. Flexner, Chief
Regulated Industries Section
Antitrust Division
Department of Justice

DONALD A. KAPLAN
Donald A. Kaplan

JAMES P. DENVIR, III
James P. Denvir, III

ABBOTT B. LIPSKY, JR.
Abbott B. Lipsky, Jr.

PETER J. TOMAO
Peter J. Tomao

Attorneys
Regulated Industries Section
Antitrust Division
Department of Justice

THOMAS C. SPAVINS
Thomas C. Spavins

Economist
Economic Policy Office
Antitrust Division
Department of Justice

June 15, 1977

Protest of U. S. Department of Justice.

Exhibit I

Exhibit I presents projections of after-tax returns on each carrier's equity investment. Because this calculation requires information on the capital structure of each carrier's ownership interest in TAPS, which, with the exception of Sohio and Union, has not been supplied to the Commission, the calculations have been made under three different assumptions. Debt/equity percentage ratios are assumed to be either 80/20, 85/15 or 90/10 except for Sohio and Union which provided enough information to determine their debt/equity percentage ratios to be 86/14 and 89/11, respectively. These debt/equity percentage ratios are all lower than the ratio for all other United States crude oil and petroleum product pipeline companies, which stood at 92.9/7.1 in 1975.[1] To the extent that actual debt/equity percentage ratios exceed those assumed, the actual returns to equity will be greater than those projected in Table I.

1. Statement of David L. Jones, Economist, Bureau of Economics, ICC, in Ex Parte No. 308, Valuation of Common Carrier Pipelines (April 28, 1977), Table 6.

Protest of U. S. Department of Justice.

TABLE I*

	Exxon	BP	Sohio	Arco	Mobil	Hess	Union
1. Requested Tariff	6.27	6.35	6.16	6.04	6.31	6.44	6.09
2. Annual Volume	87.6	69.2	146.0	92.0	21.9	6.6	7.3
3. Revenue	549.3	439.4	899.4	555.7	138.2	42.5	44.5
4. Expenses	286.5	250.8	530.2	320.8	79.0	24.2	22.6
5. "Net" Income	262.8	188.6	369.2	234.9	59.2	18.3	21.9
6. Income Taxes	139.7	199.7	195.7	124.2	31.3	9.7	11.6
7. Income After Taxes	123.1	88.9	173.5	110.7	27.9	8.6	10.3
8. Cost of Pipeline Share	1800	1426	3152	1890	450	135	144
9. Estimated Equity							
90/10	180	142.6		189.0	45.0	13.5	15.8
85/15	270	213.9	440.0	283.5	67.5	20.3	
80/20	360	285.2		378.0	90.0	27.0	
10. Return on Equity							
90/10	68.4	62.3		58.6	62.0	63.7	65.2
85/15	45.6	41.6	39.4	39.0	41.3	42.4	
80/20	39.2	31.2		29.3	31.0	31.9	

* Item 1 is in dollars per barrel. Item 2 is in millions of barrels per year.
Items 3-9 are in millions of dollars. Figures in Item 10 are percentages.

EXPLANATION OF TABLE I

Item 1 lists the tariff level filed by the respective carrier.

Item 2 presents each carrier's share of annual throughput, equal to the ownership share, multiplied by 438 million barrels per year, the estimated annual throughput. The annual throughput was obtained by multiplying the estimated daily throughput of 1.2 million barrels per day, expected to be achieved by fall of 1977, by 365 days.

Item 3 presents projected annual revenue for each carrier under its filed tariff, equal to the tariff level (Item 1) multiplied by projected annual throughput (Item 2).

Item 4 presents each carrier's projected total expenses (including all allowances for depreciation, provision for removal and restoration, miscellaneous non-income pipeline taxes, etc.) as submitted by the carrier to the Commission.

Item 5 presents each carrier's projected annual earnings, equal to total projected revenue (Item 3) minus claimed total expenses (Item 4).

Item 6 presents income taxes payable on total projected earnings (Item 5). This represents a composite rate derived as follows: Alaska taxes equal to 9.4% are deducted first, after which federal taxes of 48% are payable, for a composite rate of 52.89%.[1]

Item 7 presents each carrier's after-tax income, equal to net earnings (Item 5) minus taxes (Item 6).

*Item 8** presents each carrier's share of total pipeline construction costs, currently claimed to be $9 billion.[2]

1. Mortada, at IV-23.
2. *Id.* at IV-19.

*Item 9** presents estimated equity investment for each carrier under each of the three debt/equity percentage assumptions outlined above. Each carrier's share of total construction costs is assumed equal to that carrier's total capital investment.

*Item 10** presents each carrier's projected after-tax return on equity, equal to that carrier's projected after-tax earnings (Item 7) divided by that carrier's equity investment under each capital structure assumption (Item 9).

EXHIBIT II

Table II presents the calculation of maximum permissible tariffs for each carrier under each of the three capital structure assumptions described in Exhibit I. The estimates for Sohio reflect the 86/14 debt/equity percentage ratio calculated from Schedule V of its letter to the Commission of June 13, 1977, discussed in the explanation of Exhibit I, above. The estimates for Union reflect the 89/11 debt/equity percentage ratio calculated from its letters to the Commission of May 27 and June 14, 1977, which are also discussed in Exhibit I, above.

* In a letter dated June 13, 1977 to the Commission, Sohio furnished sufficient additional information to allow calculation of its estimated debt/equity percentage ratio. In schedule V to that letter, Sohio estimates its total capital to be $3151.5 million of which $2707.5 million is debt and $444 million is equity. This produces a debt/equity percentage ratio of 86/14. These estimates were used in place of the assumptions in Items 8, 9 and 10.

In letters dated May 27 and June 14, 1977 to the Commission, Union furnished sufficient additional information to allow calculation of its estimated debt/equity percentage ratio. Union estimates its total capital to be $144.2 million of which $128.4 million is debt, leaving $15.8 million in equity. This produces a debt/equity percentage ratio of 89/11. These estimates were used in place of the assumptions in Items 8, 9 and 10.

TABLE II*

		BP			Sohio	Union
		80/20	85/15	90/10	86/14	89/11
1.	System Share	15.84	15.84	15.84	33.34	1.66
2.	Annual Volume	69.4	69.4	69.4	146.0	7.3
3.	Cost of Pipeline	1425.6	1425.6	1425.6	3151.5	144.2
4.	Debt	1140.5	1211.8	1283.0	2707.5	128.4
5.	Equity	285.1	213.8	142.6	444.0	15.8
6.	Interest	118.9 1/	118.9 1/	118.9 1/	252.5	9.6
7.	Depreciation	60.0 2/	60.0 2/	60.0 2/	126.2	5.8
8.	Removal Costs	7.2	7.2	7.2	14.0	.7
9.	Operating Expenses	38.4	38.4	38.4	82.3	3.8
10.	Pipeline Taxes	26.3	26.3	26.3	55.1	2.7
11.	Total Expenses	250.8	250.8	250.8	530.1	22.6
12.	Return on Equity	39.9	29.9	20.0	62.2	2.2
13.	Imputed Income Taxes	44.8	33.6	22.5	70.1	2.5
14.	Total Revenue Required	335.5	314.3	293.3	662.4	27.3
15.	Maximum Permissible Tariff	4.83	4.53	4.23	4.54	3.74

* Item 1 is a percentage. Item 2 is in millions of barrels per year. Items 3-14 are in millions of dollars. Item 15 is in dollars per barrel.

1/ This item includes some Alyeska Pipeline Service Co. interest which has not been included in Item 9.

2/ This item includes $8 million "BP Pipeline depreciation."

TABLE II (con't)

		Arco			Hess		
		80/20	85/15	90/10	80/20	85/15	90/10
1.	System Share	21.0	21.0	21.0	1.5	1.5	1.5
2.	Annual Volume	92.0	92.0	92.0	6.6	6.6	6.6
3.	Cost of Pipeline	1890.0	1890.0	1890.0	135.0	135.0	135.0
4.	Debt	1512.0	1606.5	1701.0	108.0	114.8	121.5
5.	Equity	378.0	283.5	189.0	27.0	20.2	13.5
6.	Interest	140.2	140.2	140.2	11.3	11.3	11.3
7.	Depreciation	77.2	77.2	77.2	5.8	5.8	5.8
8.	Removal Costs	13.2	13.2	13.2	0.6	0.6	0.6
9.	Operating Expenses	56.0	56.0	56.0	4.0	4.0	4.0
10.	Pipeline Taxes	34.3	34.3	34.3	2.5	2.5	2.5
11.	Total Expenses	320.9	320.9	320.9	24.2	24.2	24.2
12.	Return on Equity	52.9	39.7	26.5	3.8	2.8	1.9
13.	Imputed Income Taxes	59.4	44.6	29.7	4.2	3.1	2.1
14.	Total Revenue Required	433.2	405.2	377.1	32.2	30.1	28.2
15.	Maximum Permissible Tariff	4.69	4.40	4.10	4.88	4.58	4.27

Protest of U. S. Department of Justice.

TABLE II (con't)

	Exxon		Mobil		
	85/15	80/20	85/15	80/20	90/10
1. System Share	20.0	20.0	5.0	5.0	5.0
2. Annual Volume	87.6	87.6	21.9	21.9	21.9
3. Cost of Pipeline	1800.0	1800.0	450.0	450.0	450.0
4. Debt	1530.0	1440.0	382.5	360.0	405.0
5. Equity	270.0	360.0	67.5	90.0	45.0
6. Interest	114.5	114.5	32.8	32.8	32.8
7. Depreciation	73.7	73.7	18.1	18.1	18.1
8. Removal Costs	16.4	16.4	8.5	8.5	8.5
9. Operating Expenses	49.5	49.5	11.4	11.4	11.4
10. Pipeline Taxes	32.4	32.4	8.3	8.3	3
11. Total Expenses	286.5	286.5	79.1	79.1	79.1
12. Return on Equity	37.8	50.4	9.5	12.6	6.3
13. Imputed Income Taxes	42.4	56.6	10.7	14.1	7.1
14. Total Revenue Required	366.7	393.5	99.3	105.8	92.5
15. Maximum Permissible Tariff	4.19	4.49	4.53	4.83	4.22

Protest of U. S. Department of Justice.

EXPLANATION OF TABLE II

Item 1 presents each carrier's percentage ownership in the system.

Item 2 presents each carrier's share of total projected annual throughput (See Item 2, Table I).

*Item 3** presents each carrier's share of total claimed system construction costs. This item assumes a cost of $9 billion based on the Mortada study. An increase in allowed total pipeline cost would increase the estimated tariffs in the following manner. Using the same methods used throughout this table, the estimated per barrel tariff would increase by 1.0 cent for each $100 million increase in the cost of the pipeline, assuming an 85/15 debt/equity ratio. The increase in the estimated tariff would be 1.4 cents per barrel for each additional $100 million in pipeline cost at a debt/equity capitalization of 80/20 and would be .7 cents at a debt/equity capitalization of 90/10. (See Item 8, Table I).

*Item 4** presents each carrier's debt burden under each capital structure assumption (See Item 9, Table I).

Item 5 presents each carrier's equity share, equal to its total cost share (Item 3) minus its debt burden (Item 4).

Item 6 presents each carrier's interest payments, as claimed in filings made to the Commission (Account 650).

Item 7 presents each carrier's share of annual depreciation, as presented in filings made to the Commission (Account 540).

Item 8 presents each carrier's annual contribution to funds for removal and restoration, as presented in filings made to the Commission (Account 660).

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* As discussed in the Explanation of Table I, Sohio and Union have furnished additional data concerning their estimated debt and equity. Those figures are used in Items 3 and 4.

Protest of U. S. Department of Justice.

Item 9 presents each carrier's total annual operating expenses, as presented in filings made to the Commission, less depreciation (Account 540), pipeline taxes (Account 580), interest (Account 650), and provision for removal and restoration (Account 660), which are taken into account in Items 7, 10, 6, and 8, respectively. (Alyeska interest included in Account 650 has been *included* in this item.[1])

Item 10 presents each carrier's share of pipeline taxes, as presented in filings to the Commission (Account 580).

Item 11 presents total expenses for each carrier, equal to the sum of:

Item 6: Interest
Item 7: Depreciation
Item 8: Provision for removal and restoration
Item 10: Pipeline taxes

Item 12 presents, for each carrier, the amount of after-tax earnings required to yield that carrier an after-tax rate of return on equity of 14%.[2]

Item 13 presents total income taxes which would have to be paid to yield the after-tax earnings shown in Item 12. Since the composite tax rate is 52.89%, (see Item 6, Table I), Item 13 equals (Item 12) × 100/47.11 — (Item 12) = (Item 12) × 1.123.

Item 14 presents total annual revenue requirements for each owner, equal to the sum of:

Item 11: Total expenses
Item 12: Return on equity
Item 13: Imputed income taxes

1. BP share of Alyeska interest has been included in Item 3 and not in Item 9.
2. See p. 4, *supra*.

Protest of U. S. Department of Justice.

Item 15 presents fully allocated cost per barrel for each carrier, which also equals the average tariff required to yield each owner a 14% after-tax return on equity under each capital structure assumption.

[Certificate of Service omitted in printing]

Protest of Arctic Slope Regional Corporation For Suspension of Initial Rates and Rules for Transportation of Petroleum Via the Trans Alaska Pipeline System, June 15, 1977.

[Caption omitted in printing]

PETITION AND COMPLAINT BY ARCTIC SLOPE REGIONAL CORPORATION FOR SUSPENSION OF INITIAL RATES AND RULES FOR TRANSPORTATION OF PETROLEUM VIA THE TRANS ALASKA PIPELINE SYSTEM (TAPS) FROM PRUDHOE BAY, ALASKA, TO VALDEZ, ALASKA, AND FOR AN INVESTIGATION THEREOF

The Arctic Slope Regional Corporation (ASRC), an Alaska business for profit corporation created pursuant to the Alaska Native Claims Settlement Act, 85 Stat. 688, 43 U.S.C. 1601 *et seq.*, on behalf of ASRC and its 4,000 Inupiat Eskimo shareholders, files this petition in which ASRC seeks:

A. Suspension of the rates and rules published by:

1. Sohio Pipe Line Company, ICC No. 742, issued June 3, 1977, effective June 20, 1977,* ($6.16);

2. BP Pipelines Inc., ICC Nos. 1 and 2, issued May 31, 1977, effective June 20, 1977,* ($6.35);

3. Mobil Alaska Pipeline Co., ICC Nos. 1 and 2, issued June 10, 1977, effective June 20, 1977,* ($6.31);

4. Amerada Hess Pipeline Corporation, ICC Nos. 1 and 2, issued June 1, 1977, effective July 1, 1977, ($6.44);

5. ARCO Pipe Line Company, ICC No. 1030, issued May 31, 1977, effective June 30, 1977, ($6.04);

Protest of Arctic Slope Regional Corporation.

6. Exxon Pipeline Company, ICC Nos. 124 and 125, issued June 8, 1977, effective June 20 and 30, 1977, respectively, ($6.27);

all of which are for the transportation of petroleum via Trans Alaska Pipeline System (TAPS) from Prudhoe Bay, Alaska, to Valdez, Alaska; and

B. The institution of an immediate investigation of the justification for and lawfulness of such rates and rules.

I.

SUMMARY STATEMENT

Eight pipeline companies, six of which have issued tariffs only days before they are to become effective,[1] are owned by vertically integrated corporations that control production of crude oil at Prudhoe Bay, on Alaska's Arctic Slope, shipment of that oil through TAPS and from Valdez to points of entry in the lower 48 states, and distribution within the United States. The proposed tariffs at rates between $6.04 and $6.44 per barrel, would drastically reduce the well-head price upon which royalties payable to the State of Alaska and approximately 100,000 Alaska Natives are determined. This would, in effect, postpone payment and thereby reduce the value of $500 million that Congress has determined to be owing to the Natives. In addition, the reduced well-head price would establish an entry barrier that would eliminate any incentive for other production companies to make the investment necessary to exploit other reserves not now being developed by the eight cor-

* Rates tariffs effective dates postponed to June 30, 1977, by Supplemental Notice of the Interstate Commerce Commission served June 13, 1977.

1. Two companies, Phillips Petroleum Co. and Union Alaska Pipeline, have not yet issued their initial tariffs.

porations. Such a barrier would effectively negate the value of several million acres of Arctic Slope lands that Congress granted to Arctic Slope Eskimos in exchange for the Prudhoe Bay oil reserves now held by the eight oil companies that own the pipeline companies.

In order to justify these extraordinarily high tariffs to reduce well-head price, the carriers include, among others, the following erroneous factors and methods in their computations: (1) an unreasonably high capital basis; (2) an excessive rate of return on equity; (3) an incorrect deduction of interest; (4) improper methods of valuation; (5) improper assumptions about throughput; (6) a service life of 25 rather than 35 years; and (7) failure to account for the availability of capital guaranteed by deferral of expenses. Any of these errors and also the proposed discriminatory and unreasonable rules, and the anticompetitive effect of the tariffs are *prima facie* evidence that the tariffs are unjust and unreasonable and require suspension and investigation in the public interest.

II.

BACKGROUND

Prior to the enactment of the Alaska Native Claims Settlement Act ("ANCSA") on December 18, 1971, the Inupiat Eskimos had claims of unextinguished aboriginal title based on use and occupancy since time immemorial to the entire Arctic Slope of the State of Alaska. Federal Field Committee for Development Planning in Alaska, *Alaska Natives and the Land*, 459, Figure V-19 (1968) [hereinafter cited as Fed. Field Comm.] (North Slope Native Association Protest to Land Selections by State of Alaska, Protest #F-035257); 43 U.S.C. §1601(a). Other Native people of

Alaska (Eskimos, Aleuts, and Indians) had similar and substantial claims to other areas of the State. Fed. Field Comm., ch. 5. The Supreme Court has repeatedly declared that such claims are protected by federal law and can be extinguished only by Act of Congress. *Oneida Indian Nation* v. *County of Oneida,* 414 U.S. 661 (1974); *United States* v. *Santa Fe Pac. R.R.,* 314 U.S. 339 (1941). From the acquisition of Alaska in 1867 until 1971, Native rights of use and occupancy were preserved and protected by Congressional acts [Act of May 17, 1884, ch. 53, § 8, 23 Stat. 24, 26; Act of March 3, 1891, ch. 561, § 14, 26 Stat. 1096, 1100; Act of June 6, 1900, ch. 786, § 27, 31 Stat. 321, 330; Act of July 7, 1958, Pub. L. No. 85-508, § 4, 72 Stat. 339 (Alaska Statehood Act)], and regulations of the Department of the Interior. (*E.g.,* 43 C.F.R. § 2091, 6-3)

In the mid-1960's, acting under color of Section 6 of the Alaska Statehood Act, *supra,* which granted the State over 104 million acres of federal land, Alaska began to select land on the Arctic Slope and elsewhere in the State. These selections included substantial areas at what is now known as Prudhoe Bay. Fed. Field Comm., ch. 5.

By all means available to them, Arctic Slope Eskimos and other Alaska Natives vigorously protested these selections. Fed. Field Comm., Figure V-19. In response to their protests and the United States' fiduciary duty to Native Americans, the Secretary of the Interior imposed a "land freeze" in 1966, halting all transfers of public lands in Alaska pending resolution of Native claims. P.L.O. No. 4582, 34 Fed. Reg. 1025 (1969); S. Rep. No. 92-405, 92d Cong., 1st Sess. 97 (1971) (discussing Native protests and resulting informal freeze orders). The land freeze, which was judicially upheld in *State of Alaska* v. *Udall,* 420 F. 2d 938 (9th Cir., 1969), greatly increased pressure on Con-

gress to resolve the competing claims of Alaska Natives and the State of Alaska.

In 1968 oil was discovered at Prudhoe Bay on the Arctic Slope. Subsequently, on December 18, 1971, Section 4 of ANCSA extinguished all aboriginal land claims in Alaska, including the Arctic Slope Eskimos' claim to Prudhoe Bay. 43 U.S.C. § 1603. ANCSA also transferred to the State of Alaska substantial portions of Prudhoe Bay that had been selected by the State under color of the Statehood Act. 43 U.S.C. §1613(g).

As compensation for that extinguishment, ANCSA granted Alaska Natives fee title to approximately 40 million acres of land. 43 U.S.C. §§1611, 1613. All future revenues derived from that land will be the property of the Alaska Native people. 43 U.S.C. §1606.

Additionally, ANCSA provided for a cash settlement of $962,500,000 to be paid over a period of years. $462,500,000 will be paid by the United States from appropriated funds. 43 U.S.C. §1605. The remainder will be paid from revenues derived from a 2% royalty on the well-head value of all crude oil production in Alaska under state or federal leases. 43 U.S.C. §§1605, 1608.

Prior to the passage of ANCSA, eight oil companies that had state leases on the 10 billion barrel reserves at Prudhoe Bay joined together to form a consortium for the construction and operation of the Trans Alaska Pipeline System ("TAPS"). Subsequent to ANCSA, those companies formed Alyeska Pipeline Service Company. After numerous delays and significant litigation, Congress acted to authorize directly construction of TAPS and to assure full federal cooperation. Trans-Alaska Oil Pipeline Authorization Act of November 16, 1974, 67 Stat. 557, 43 U.S.C. §§ 1651-55. One of the reasons advanced by the pipeline companies for passage of that Act was that early completion of the pipeline would benefit Alaska Natives.

III.

STANDING

ASRC and the twelve other regional corporations have specific responsibilities in the administration of ANCSA's land claims settlement. These responsibilities include investment and distribution of settlement funds, selection of lands granted under the Act, management of those lands, and provision of assistance to village corporations. *See generally* 43 U.S.C. § 1606.

ASRC, for the benefit of its nearly 4,000 Inupiat Eskimo shareholders, was granted selection rights to approximately 5 million acres of surface and subsurface lands on the Arctic Slope of Alaska. Since 1972 ASRC has selected its entitlement and has received interim conveyances to approximately 4.5 million acres from the United States. A large portion of the lands selected by or conveyed to ASRC are immediately accessible to TAPS. If, as is likely, oil reserves suitable for commercial development are found on these lands, crude oil will be tendered for shipment on TAPS by ASRC or its lessees.

On at least four distinct grounds, ASRC has legal and equitable standing in these proceedings to petition the Commission and to protest the initial rates published by the Sohio Pipe Line Company, BP Pipelines, Inc., Mobil, Alaska, Amerada Hess Pipeline Corporation, ARCO Pipe Line Company, and Exxon Pipeline Company:

1. ASRC's status as the owner or prospective owner of 5 million acres of potential oil and gas producing lands on Alaska's North Slope. In this capacity, ASRC is a land owner the value of whose oil and gas properties is directly increased or decreased by the amount of the TAPS tariff.

2. ASRC's status as a prospective shipper of crude oil through TAPS.

3. ASRC's status as the recipient of the Inupiat Eskimos' share of the 2 percent royalty on all crude oil production in Alaska under State or Federal leases. The higher the well-head value of oil produced under such leases, the sooner the Alaska Native Fund will receive and distribute the $500 million granted by ANCSA. Any delay in the receipt of royalty payments substantially reduces the value of those payments to all Alaska Natives.

4. ASRC's status as the beneficiary of a proportionate share of seventy percent of all revenues from crude oil production on the lands owned by the other 11 regional Native Corporations.

In each of these instances, ASRC's revenues will be diminished to the extent that crude oil owned by ASRC, or crude oil owned by others to which ASRC has a revenue entitlement, is shipped through TAPS at the proposed rates. For a summary of the effect of TAPS' tariffs on the well-head price of Arctic Slope Crude Oil and the payout period for the Alaska Native Fund, see Exhibit A attached hereto.

IV.

STATEMENT OF REASONS

A. The Factual Basis and Method Used by the Carriers to compute the Proposed Tariff are Inaccurate and Improper.

By letter dated June 13, 1977, the Sohio Pipe Line Company responded to the Commission's "Request For Prompt

Filing of Data Concerning Proposed Rate Levels". The information provided in this letter and the estimated cost data supplied by Sohio under separate letter dated June 14, 1977, to the Section of Audit, demonstrate that an inaccurate factual basis and improper method were used by the TAPS carriers in determining the proposed tariffs.

The following general discussion of factual basis and method used to determined the tariffs draws primarily upon this Sohio data. Sohio Pipe Line Company has a 33⅓ percent interest in TAPS. The conclusions which are drawn based upon the Sohio data will vary, of course, in some minor respects from other carriers depending upon their respective costs of operation and capital costs.

(i) *The rate tariffs are based upon an unreasonably high capital base.*

The Sohio data indicates that total capital expenditures by all TAPS carriers as of September 1, 1977, including capitalized taxes and overhead, and capitalized interest for the TAPS is $9.271 billion (Sohio letter dated June 13, 1977, Schedule V; Total 3090.4 multiplied by a factor of 3). This projected total capital cost is substantially in excess of the $900 million estimate first advanced by TAPS proponents in 1969. Speech by E. L. Patton, Chairman, Alyeska Pipeline Service Company, to Town Hall of California (May 17, 1977). This increase, in part, is the result of more than eight years' inflation and the cost of providing for environmental safeguards; however, Touche Ross and the General Accounting Office, among others, currently are investigating the extent to which a portion of this increase may be attributable to mismanagement and waste. If such mismanagement and waste is substantiated, these costs should not be passed on to the TAPS shippers and ultimately to

the American consumer. Also, to the extent the interest rates on the TAPS debt exceed a reasonable amount and are not comparable to rates paid by affiliates of the TAPS carriers, the excess should not be passed on to the TAPS shippers and the consumer. If a reduction in the capital cost is made for these items, the adjusted figures would have a dramatic impact resulting in the calculation of a more reasonable rate tariff. Until these studies are complete, the proposed rate tariffs should be suspended.

(ii) *The proposed rate tariffs would yield an unreasonably high rate of return on equity.*

Assuming that all of its other calculations are correct, the Sohio data suggests that Sohio equity during 1978 and 1979 will total no more than $569.3 million (*Id.*, Schedule V) and net income after imputed taxes will total approximately $176 million and increase substantially thereafter. (Id., Schedule I) Using these figures, the rate of return on equity will be approximately 31 percent and the actual rate of return is substantially greater because, *inter alia*, net income is computed after imputed but unpaid taxes and after deduction of an improper depreciation allowance and amortization of expenses. The TAPS operation, constituting a monopoly, will be virtually free of risk and will continue without competition for many years; and a rate of return on equity which is more closely in line with that found in unregulated industries is required.

(iii) *The justifications for the proposed rate tariffs improperly deduct interest expense in calculating the rate of return on the valuation of the TAPS system.*

Assuming, as Sohio has determined, that the rate tariff should be based on a seven percent[2] rate of return on valua-

2. The Sohio justification (Id., Schedule I) inaccurately cites a 1941 Elkins Act Consent Decree as authority for the use of a seven percent rate of return in the amount of valuation of a pipeline. However, this decree was not concerned with what constitutes a reasonable rate of return but rather with the amount of dividends that may be paid by a controlled pipeline company to its parent without constituting an illegal rebate.

tion rather than on equity, which ASRC denies, Sohio's computation actually results in a rate of return in excess of seven percent because interest on debt is deducted as an expense item before computation of the rate of return at the same time that borrowed capital is included in the capital base. Deduction of interest, which averages 9.3 percent (Id., Schedule III) and is paid upon borrowed funds, and inclusion of borrowed funds in the base upon which the seven percent is calculated will give the carriers a classic "double dip" at the expense of shippers and the American public, and plainly results in excessive and unreasonable rate tariffs.

(iv) *The proposed tariffs are based upon an improper method of valuation.*

Since the Commission first was given jurisdiction over pipeline rates with the passage of the Hepburn Act in 1906, it has had occasion to consider in depth the reasonableness of pipeline rates in four major cases. *Reduced Pipe Line Rates and Gathering Charges,* 342 I.C.C. 115 (1940); *Petroleum Rail Shippers' Assn.* v. *Alton & S.R.,* 243 I.C.C. 589 (1941); *Minnelusa Oil Corp.* v. *Continental Pipe Line Co.,* 358 I.C.C. 41 (1944); and *Petroleum Products Williams Bros. Pipe Line Company,* 351 I.C.C. 102 (1975), aff'd on reconsideration, I.C.C. (Docket 3553, served December 21, 1976). In these cases the Commission has permitted allowance for reproduction costs in the valuation formula.

The use of reproduction costs for valuation is virtually unique to the Commission and results in pipeline companies realizing rates of return which significantly exceed rates permitted other public utilities. Also, this use results in a

double charge to the shipper for the cost of inflation because inflation is reflected also in operating expenses and in allowances for return on equity and on borrowed funds.

In Sohio's letter to the Commission dated June 13, 1977, Schedule V, reproduction costs are reflected by the use of a factor of 1.06 in determining "Going Concern" Value. This value is increased by this same factor each year.

Use of reproduction costs has been challenged by the Justice Department, among others, as creating an excessive rate of return for pipeline companies. Presently, this issue is under review by the Commission in Ex Parte 308 (Sub-No. 1), *Investigation of Common Carrier Pipelines.*

Based upon the foregoing discussion, allowance for reproduction costs in general, and the use of an annual factor of 1.06 to determine "Going Concern" Value, in specific, should not be permitted until conclusion of the Commission's pending review of valuation in Ex Parte 308, *supra.*

(v) *The carrier justifications incorrectly assume throughout of 1.2 million barrels per day, increasing to 1.55 million in 1980.*

The Sohio projection of throughput (June 13, 1977 letter of Sohio, Schedule II), which corresponds with that of Amerada Hess, varies dramatically from earlier projections of 2 MMbpd (million barrels per day). See, Note, 81 Yale L. J. 1592, 1627 n. 156. Since operating income will increase dramatically if projected throughput is understated, the Commission should investigate the lower projection and require the carriers to more fully justify their projection.

(vi) *The rate tariffs are improperly based upon a 25-year amortization of Dismantling and Restoration Expenses, Depreciation is improperly based upon a term of 25 years, rather than a more reasonable term of 35 years.*

The carriers have estimated the TAPS useful life to be 25 years. (Sohio letter to the Commission dated June 13, 1977, Schedules IV and VI). But, the useful life of other pipelines owned by TAPS carriers range between 31 and 42 years and previous estimates establish TAPS' useful life at 35 years. If TAPS' useful life were 35 years, yearly amortization would be $30 million instead of $42 million, assuming total dismantling costs of $1.05 billion, and annual depreciation would be $222.86 million instead of $312 million (assuming net property of $7.8 billion).

The Commission should investigate TAPS' useful life and require the carriers to justify their calculation. In its June 13, 1977 letter, Sohio states that the 25-year useful life is based on the estimated life of the oil fields served by TAPS. However, such estimates ignore the useful lives of adjacent and parallel fields which will also be served by TAPS.

(vii) *The tariffs fail to consider the substantial amount of capital generated by non-cash deductions.*

Substantial cash flow is made available to the carriers from depreciation, deferred taxes, and amortized dismantling costs. This cash flow to the carriers is a direct result of payments of rates by shippers and offsets requirements for working capital. These items should be included to reduce cost of operation of TAPS, which will result in increased net income.

(viii) *Failure to properly justify and calculate the rate tariffs requires that they be suspended.*

As demonstrated above, in the preceding paragraphs, *prima facie* the justification for the extraordinary tariffs proposed by the TAPS carriers are unjust and unreasonable. The burden of justifying new, assailed rates as just and reasonable rests upon the proponent-carrier, *Baltimore & Ohio Chicago Terminal R. R.* v. *United States,* 279 F. Supp. 270, 274 (N.D. Ill.), aff'd, 389 U.S. 88 (1967), and the basis for calculation of the tariffs, as disclosed to date by the TAPS carriers, indicates that the burden cannot be met.

B. THE ANTICOMPETITIVE EFFECT OF THE JOINT VENTURE TAPS OPERATION, AS MANIFESTED IN THE PROPOSED TARIFFS, REQUIRES INVESTIGATION BY THE COMMISSION OF POSSIBLE VIOLATIONS OF THE CLAYTON ACT.

In Ex Parte No. 308 (Sub. No. 1), *Investigation of Common Carrier Pipelines,* the Commission is studying whether shipper ownership of petroleum pipelines has undesirable anticompetitive effects, and this issue is one which has concerned the Congress. See, House Report No. 92-617, "Anticompetitive Impact of Oil Company Ownership of Petroleum Products Pipelines" (October 18, 1972).

A significant anticompetitive effect may result if the proposed tariffs are not suspended. Under pending FEA proposed rule making, it appears that the West Coast price per barrel of oil will be approximately $11.50. Based on the proposed rate tariffs of approximately $6.25 and the shipment costs from Valdez of $1.00, the well-head price will be $4.25. This well-head price is so low that it would reduce significantly the number of oil companies not members of the TAPS consortium that will bid on the development of new oil fields on the Arctic Slope and it also will dramatically

reduce their bids. By comparison, members of the pipeline consortium would find it more feasible to bid on such new fields because their high rate of return on investment from TAPS offsets any reduced profit from production. The TAPS carriers' unlawful purpose in setting high tariffs thereby is apparent.

As the owner of approximately five million acres of Arctic Slope lands which may contain significant oil reserves, ASRC has a major stake in preserving competition. This interest is shared with other native regional corporations which own lands with potential reserves and which are entitled under §7(i) of ANCSA to 70% of mineral revenue from any one region. As a result of this anticompetitive effect, the Alaska Natives $500 million fund created under the ANCSA would be reduced substantially in value and the possibility of exploitation of other oil reserves at a reasonable well-head price will be diminished at the expense of the Natives and consumers.

V.

AN ACCEPTABLE INITIAL RATE

ASRC, consistent with the position it has taken in this petition on the need for a suspension and the establishment of appropriate standards on which the carriers' tariffs can be lawfully based, would not object to tariffs being filed on one day's notice by Sohio Pipe Line Company not exceeding $3.16, by BP Pipelines, Inc., not exceeding $3.04, by Mobil, Alaska, not exceeding $3.31, by Amerada Hess Pipeline Corporation, not exceeding $3.44, by ARCO Pipeline Company not exceeding $3.35 and by Exxon Pipeline Company not exceeding $3.27.

ASRC's position on an acceptable initial rate is, of course, conditioned upon establishment of a procedure for

appropriate adjustment of such rates following the Commission's final determination of a justifiable and lawful rate. An appropriate annual interest rate on any refunds would be the higher of either: (1) a rate two points above the mean prime rate during the period in which the carriers had the benefit of any excess charges, or (2) the equivalent of the mean internal rate of return achieved by the carriers during the same period on retained earnings committed to their own operations. Presumably, in their own affairs, the carriers would always invest their own funds in the higher of the two alternatives. Any lesser rate would constitute de facto forced lending by Alaska Natives to the carriers at an interest rate below commercial market rates.

ASRC acknowledges that in suspension proceedings in which carriers and producers have independent interests, it may be appropriate for the Commission to favor a carrier with the benefit of any doubts. However, for many independent reasons that presumption should not be applied where the carriers and producers have substantially unitary interests.

The principal reason to favor the carrier in an ordinary suspension proceeding is the carrier's inability, retroactively, to recover upward adjustments from the shipper. However, in these proceedings, if the final tariff were to be adjudicated at a higher rate than the initial tariff, most of any profits lost by the companies from their pipeline operations would be recouped by their production operations. Conversely, those companies can recoup from pipeline profits any loss of well-head crude values that are caused by excessive TAPS tariffs.

Futhermore, the companies have strong incentives to maximize profits from their pipeline rather than from their crude oil production. One incentive is to avoid royalty pay-

ments to the State of 12.5% from which the Native corporations derive their 2% royalty. Another is to avoid the State's 12.25% severance tax. Each of these items, as previously discussed, is based upon well-head value of crude oil which in turn is inversely related to the TAPS tariffs.

In addition to the considerations outlined above, an initial tariff that exceeds the $3.00 to $3.50 range combined with a refund interest rate less than that described above would also be adverse to sound public policy. Any such combination would:

(1) be a substantial incentive for the TAPS companies to delay, for as long as possible, production of necessary information and a final adjudication of proper tariffs;

(2) negate congressional interest that Alaska Natives be compensated promptly for the extinguishment of their aboriginal lands claims;

(3) substantially reduce the value of compensation provided ASRC and other Alaska Natives by ANCSA;

(4) perpetuate an insurmountable entry barrier to development of additional Alaska oil reserves by companies other than those controlling TAPS; and

(5) result in windfall gains to the TAPS companies.

Extraordinary procedural considerations also require the lowest possible initial tariff. For example, assuming that after a long and complicated proceeding, the Commission were to conclude that ARCO Pipe Line Company had overcharged Atlantic Richfield Company by $3.00 per barrel. Atlantic Richfield, the "producer," might refuse to

apply for refunds because, after such intra-corporate transfers, the refunds would be subject to Alaska's royalty and severance taxes. The State of Alaska, Atlantic Richfield's lessor, might have no way to force its lessee to apply for refunds with the result that refunds resulting from the excessive interim tariffs *may never be paid.*

Refunds will raise several other serious questions. How would those claims be computed? Would they include a prorata share of the refund interest? Could the State and producer companies offset other claims against each other? Could the State and pipeline companies offset other claims against each other?

More importantly to ASRC, will the Commission ensure that ASRC and other Native corporations get their prorata shares of any such refunds? In short, (i) because of the vertical integration and interrelationships of all the producing and pipeline companies in these proceedings, (ii) because of the attenuated ability of first the State and then ASRC to obtain their respective shares of any refunds, and (iii) because of the absence of substantial harm to the producing and pipeline companies from a low initial tariff, and (iv) to avoid encouraging dilatory and delaying tactics by the pipeline companies the Commission should not approve an initial tariff that exceeds in any respect the Commission's initial view of what the ultimate tariff ought to be. The benefit of any doubt should go to the Native corporations and to the State of Alaska.

Therefore, because important public issues are involved and because substantial interests of the State of Alaska, ASRC and other Native corporations are at stake, ASRC respectfully urges the Commission to suspend the proposed rules and tariffs and to enter into an immediate investigation of the lawfulness thereof.

ARCTIC SLOPE REGIONAL CORPORATION

By O. YALE LEWIS, JR.
O. Yale Lewis, Jr.
Charles A. Goldmark

500 Maynard Building
Seattle, Washington 98104
(206) 622-9603

Of Counsel:
Wickwire, Lewis, Goldmark,
Dystel & Schorr
500 Maynard Building
Seattle, Washington 98104

By WILLIAM W. BECKER
William W. Becker
Jay T. French

1819 H Street, N. W. - Suite 950
Washington, D. C. 20006
(202) 293-1919

Its Attorneys

Becker and Feldman
1819 H Street, N. W. - Suite 950
Washington, D. C. 20006

Due Date: June 20, 1977

Date Filed: June 15, 1977

[Certificate of Service omitted in printing]

Protest of Arctic Slope Regional Corporation.

LETTERHEAD OF
ELMER FOX, WESTHEIMER & CO.

June 15, 1977

Mr. Lawrence Dinneen
Executive Vice President
Arctic Slope Regional Corporation
P.O. Box 566
Barrow, Alaska 99723

Attention: Mr. O. Yale Lewis, Jr.
Wickwire, Lewis, Goldmark, Dystel & Schorr

Dear Mr. Dinneen:

We have completed our engagement to project the present value of the royalties on crude oil to be paid into the Alaska Native Fund at varying wellhead prices under Section 9 of the Alaska Native Claims Settlement Act. The assumptions used in preparing the projection were supplied by management of the Arctic Slope Regional Corporation and the scope of our engagement did not include an evaluation of their reasonableness.

The significant assumptions are summarized below.

- *Barrels per year*—Production will be 1.2 million barrels per day or 438 million barrels per year.
- *Price per barrel*—A per barrel crude oil price of $11.50 was used.
- *Transportation Costs*—Transportation costs from Valdez, Alaska to the west coast of the United States will not exceed $1 per barrel. This sum has been subtracted from the base used in determining the price per barrel at the wellhead.

Protest of Arctic Slope Regional Corporation.

- *Limit on the Royalty Fund*—The Alaska Native Fund is limited by law to a total of $500 million. The royalty was calculated at two (2) per cent of the wellhead price.
- *Interest Rate*—An interest rate of eight (8) percent per annum, compounded annually, was used in calculating present value and payments were assumed to be made to the fund at the end of the year in which they accrued.

Based on the accompanying schedule, we believe the royalties to be paid into the Alaskan Native Fund have a greater present value to the Fund's recipients if paid over a shorter rather than a longer time period. The schedule indicates that as the wellhead price per barrel is increased, the period of royalty payments until the $500 million limit is reached is decreased. A visual presentation of the schedule is shown on the two accompanying graphs.

The projection is based on assumptions concerning future events and circumstances. The assumptions disclosed herein are those which are significant to the projection or are key factors upon which management believes the results will depend. Some assumptions inevitably will not materialize and unanticipated events and circumstances may occur subsequent to the date of this projection. Accordingly, the actual results achieved during the projection period will vary from the projection and the variations may be material.

The terms of our engagement are such that we have no obligation to update this report or to revise the projection because of events or circumstances occurring subsequent to the date of this report.

Very truly yours,

ELMER FOX, WESTHEIMER & CO.

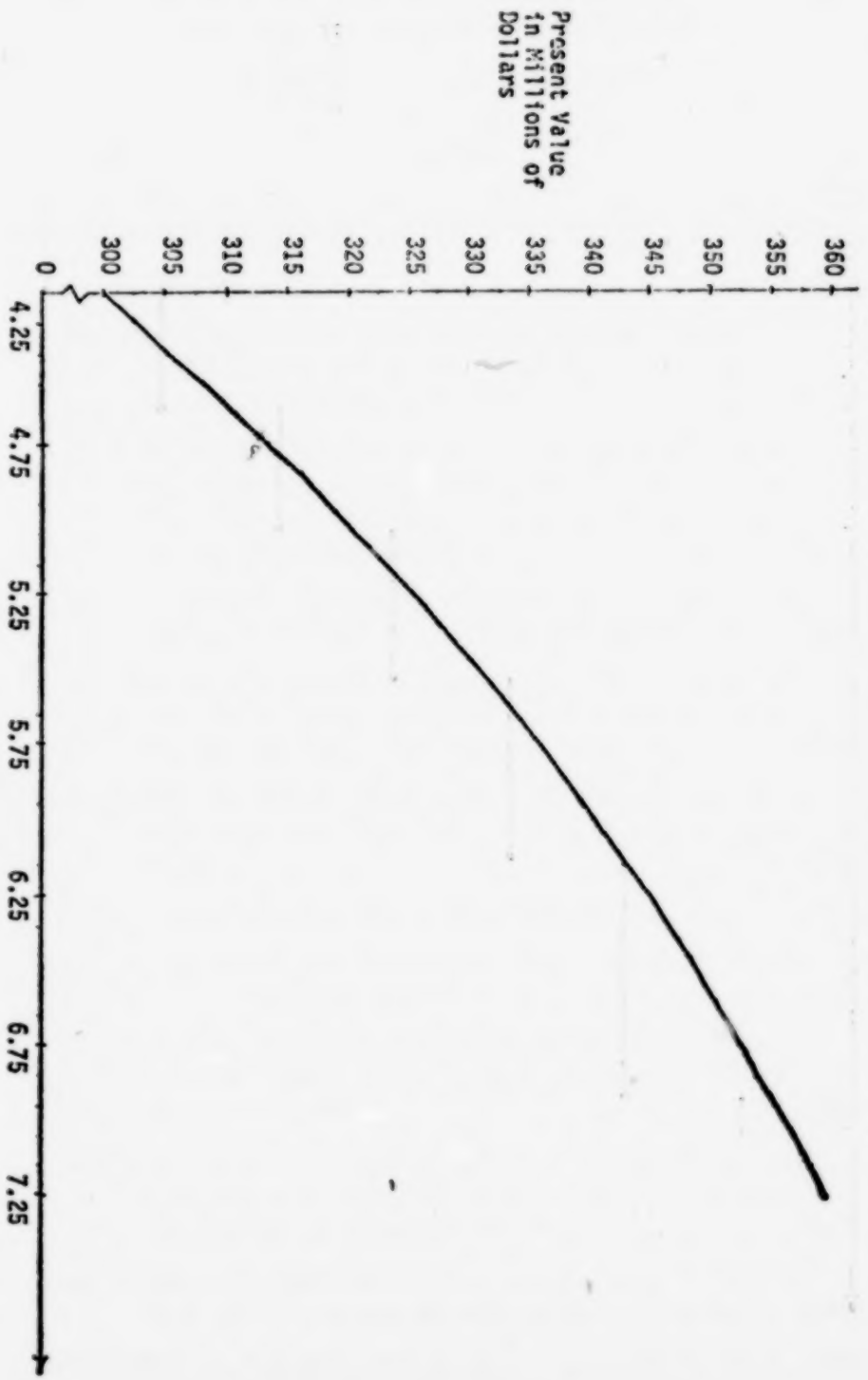
Protest of Arctic Slope Regional Corporation.

PRESENT VALUE OF ROYALTY PAYMENTS
TO THE ALASKAN NATIVE FUND
FOR CRUDE OIL AT VARYING WELLHEAD PRICES

Wellhead price per barrel	Tariff per barrel	Estimated annual royalty payments (000 omitted) 1/	Years until achieving $500 million limit	Present value of royalty payments at 8% (000 omitted)
$4.25	$6.25	$37,230	14	$300,049
4.35	6.15	38,106	14	302,755
4.45	6.05	38,892	13	305,618
4.55	5.95	39,858	13	308,354
4.65	5.85	40,734	13	311,090
4.75	5.75	41,610	13	313,826
4.85	5.65	42,486	12	316,273
4.95	5.55	43,362	12	318,701
5.05	5.45	44,238	12	321,127
5.15	5.35	45,114	12	323,555
5.25	5.25	45,990	11	325,795
5.35	5.15	46,866	11	327,916
5.45	5.05	47,742	11	330,037
5.55	4.95	48,618	11	332,158
5.65	4.85	49,494	11	334,279
5.75	4.75	50,370	10	336,273
5.85	4.65	51,246	10	338,093
5.95	4.55	52,122	10	339,914
6.05	4.45	52,998	10	341,734
6.15	4.35	53,874	10	343,555
6.25	4.25	54,750	10	345,376
6.35	4.15	55,626	9	347,173
6.45	4.05	56,502	9	348,701
6.55	3.95	57,378	9	350,229
6.65	3.85	58,254	9	351,757
6.75	3.75	59,130	9	353,286
6.85	3.65	60,006	9	354,814
6.95	3.55	60,882	9	356,342
7.05	3.45	61,758	9	357,870
7.15	3.35	62,634	8	359,356
7.25	3.25	63,510	8	360,604

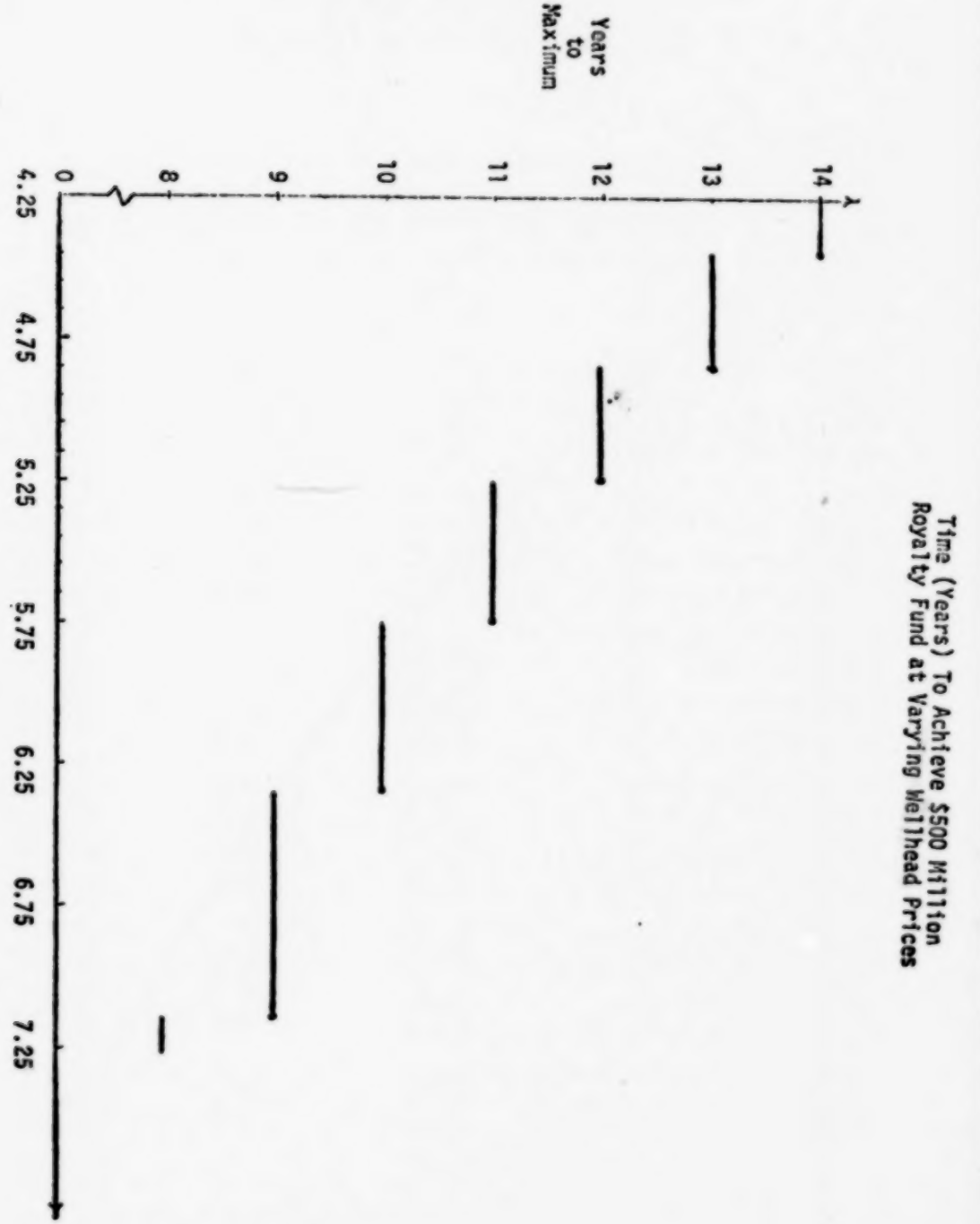
1/ In each case, the last year includes only a partial payment.

Protest of Arctic Slope Regional Corporation



Present Value of 2% Royalty at Varying Wellhead Prices

Protest of Arctic Slope Regional Corporation



Protest of the Interstate Commerce Commission's Bureau of Investigations and Enforcement for Suspension and Investigation, June 15, 1977.

[Caption omitted in printing]

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Before the

INTERSTATE COMMERCE COMMISSION

Protest And Petition For Suspension And Investigation

Effective Dates:	June 20, 1977	June 20, 1977	June 20, 1977
Tariff References:	BP Pipelines, Inc. ICC Nos. 1&2	Mobil Alaska Pipeline Co., ICC Nos. 1&2	Sohio Pipeline Co. ICC No. 742
Rates per Barrel:	635¢	631¢	616¢
Nature of Proposals:	Initial tariffs on petroleum moving from Prudhoe Bay, Alaska, to Valdez, Alaska.		
Effective Dates:	June 30, 1977	June 30, 1977	July 1, 1977
Tariff References:	Arco Pipe Line Co. ICC No. 1030	Exxon Pipeline Co. ICC Nos. 124 & 125	Amerada Hess Pipeline Corp., ICC Nos. 1&2
Rates per Barrel:	604¢	627¢	644¢
Nature of Proposals:	Initial tariffs on petroleum moving from Prudhoe Bay, Alaska, to Valdez, Alaska.		

The Bureau of Investigations and Enforcement of this Commission protests the foregoing initial tariffs, and requests the Commission to enter its order investigating the subject tariffs and suspending the effectiveness of the said tariffs during the pendency of its investigation. The Bureau further requests that the Commission permit the refiling of the said tariffs on a lower basis on one day's notice as described herein and that its order of investigation encompass any such refiled rates or rules. A refund clause and conditions ensuring the production of documents to Touche Ross & Co. should be included in the I. & S. order.

1. Background

The subject tariffs set forth the initial rates and rules of six of the eight pipeline companies owning undivided

interests in the Trans-Alaska Pipeline System (TAPS), a 48-inch line extending from the Prudhoe Bay oil field to the newly constructed Valdez Terminal in Valdez, Alaska. The main Prudhoe Bay field was discovered in 1968, and contains over 9 billion barrels of recoverable petroleum, as well as much recoverable natural gas.[1] In the recent Recommendation to the President of the Federal Power Commission (FPC Recommendation), dated May 1, 1977 on alternative proposals to construct a gas pipeline, the FPC describes the Prudhoe Bay field as containing "the largest accumulation of oil and gas ever discovered on the North American Continent" (p. III-6).

Construction of TAPS began in April 1974.[2] The owners acted through their agent, the Alyeska Pipeline Service Company (hereinafter Alyeska), which will also operate the pipeline.[3] The owners initially projected a construction cost for TAPS of just under $1 billion.[4] The latest estimates reflect capital expenditures of $8 billion plus $1.3 billion of overhead and capitalized interest.

The eight major oil companies holding interests in Alyeska are the following:

Sohio Pipeline Company	33.34%
BP Pipelines, Inc.	15.84

1. We have attached as Appendix B an extract from the so-called Van Poolin Study for the State of Alaska that describes recoverable reserves and the expected life of the field. Appendix A contains much basic cost data that we will refer to throughout this Protest.

2. The owning companies commenced construction under an agreement and grant of right-of-way authorized by the Secretary of the Interior pursuant to the Trans-Alaska Pipeline Authorization Act, 43 U.S.C. §§ 1651-55 and a further right-of-way lease between such owners and the State of Alaska.

3. Alyeska, a Delaware Corporation, was formed by the owning companies in 1970 under their TAPS Agreement of August 27, 1970.

4. New York Times, January 20, 1970, p. 63.

Arco Pipe Line Company	21.00
Exxon Pipeline Company	20.00
Mobil Alaska Pipeline Company	5.00
Union Alaska Pipeline Company	1.66
Phillips Petroleum Company	1.66
Amerada Hess Corporation	1.50

Consequently, the proposed tariffs represent 96.68 percent of the total ownership of TAPS.

Each of the foregoing companies is affiliated with a major producer in the Prudhoe Bay oil field. The companies joined in this venture pursuant to an agreement and right-of-way issued by the Secretary of the Interior under the Mineral Leasing Act of 1920, as amended, 30 U.S.C. § 185, and the Trans-Alaska Pipeline Authorization Act, 43 U.S.C. §§ 1651-55.

Congress expressly provided in Section 205 of the Authorization Act that the owner companies would not receive any immunity from the operation of the antitrust laws (43 U.S.C. § 1654). Under the amendment to the Leasing Act, the Secretary of the Interior may request the Attorney General to complain to this Commission, if the pipeline is not operating "in complete accord with its obligations as a common carrier" (30 U.S.C. § 185(r)(5)).

While joining in the construction of the pipeline, the carriers are required to compete as common carriers in its operation. Unlike the railroad or motor carrier industries, where the carriers may establish common rates, the Congress has precluded that possibility here; and hence even usual ratemaking standards like industry-wide averages may be out of place here. One pipeline has been constructed; but there are in effect eight different rates potentially to be considered.

In this Protest, we shall emphasize certain differences in costs among the owning companies. Rates based on costs will insure maximum competition. We urge that the Commission early resolve in these proceedings, (1) that the rates shall be cost-based, and (2) differences in costs warrant differences in rates.

2. *The Filed Rates May Exceed Just And Reasonable Levels Once The Cost Overruns Have Been Considered*

The enormous cost overruns connected with the construction of TAPS in themselves require the entry of an order of investigation. The potential disallowance of substantial sums from the rate base or other adjustment of a fair rate of return would necessarily have a direct impact on the allowable earnings of the respective owner companies.

The Commission recognized the need to study the economy and efficiency with which TAPS was constructed in its awarding a contract to Touche Ross & Co. on October 8, 1976, for an audit of the TAPS construction costs.[5] Although no definitive conclusions can be drawn as yet, the following issues are now under active review by Touche Ross, so that their effect, if any, on TAPS's costs will be measured:

1. The planning for costs, budgets, and facility capacities.
2. The organizing, staffing and directing of construction activities by Alyeska and others.
3. The labor contracts, employee compensation packages, labor support and labor efficiency.
4. The procurement, utilization, and maintenance of construction equipment.

5. See Press Release Nos. 215-76 and 114-77.

5. Controls over materials and supplies.
6. Rework of construction.
7. The terms and timing of owner company financing methods.
8. Compliance with environmental protection requirements.

For example, item number 6 above refers to "rework of construction." An unsually large number of pipe rewelds were required during the course of construction. In order even to obtain access to the faulty or questionable welds, large amounts of earth and backfill had to be excavated, since the affected pipe had often already been buried. The reasons for such rewelds must be explored as well as the downstream effects such a task would have caused, and a determination made as to whether any substantial part of these expenses was preventable under the circumstances.

As late as 1973, just a few months prior to actual construction, Sohio widely circulated an analysis of capital costs of TAPS and placed the cost of construction at $2.5 billion (excluding terminal) for capacity of 1.2 million barrels per day, and another $250 million to increase capacity to 2.0 million barrels per day. The following summarizes those estimates:[6]

6. Report by the Standard Oil Company, submitted to the Subcommittee on Public Land of the House Committee on Interior and Insular Affairs on April 19, 1973, and reprinted in "Rights-of-Way Across Federal Lands: Transportation of Alaska's North Slope Oil," Hearings on S. 970 before the Senate Committee on Interior and Insular Affairs, 93rd Cong., 1st Sess., Part 4 (May 3, 1973), table at p. 223.

	($ millions)
Line pipe and fittings	$ 143.0
Pipeline construction	1,298.3
Yukon River crossing	17.6
Roads	215.6
Pumping stations (12)	184.0
Communications	27.5
Materials handling	12.3
Design, engineering, research, aircraft	62.3
Offices and staff	101.2
Other	12.3
Contingency	103.5
Escalation for estimate update to June 30, 1972	359.0
Total for capacity of 1.2 million barrels per day	2,536.6
Capital required to increase capacity to 2.0 million barrels per day	250.0
TOTAL	$2,786.6

For a pipeline of 789 miles, Sohio estimated capital costs in 1973 of $2.79 billion, plus another $500 million for the Valdez terminal.[7]

In Appendix C we describe the evolution of the budget and cumulative costs associated with TAPS from under $1 billion in 1969 to over $7 billion in mid-1976. That figure is nearly $8 billion today, as we noted earlier, and does not include the $1.3 billion for interest during construction. The fact that the costs of construction have approached $9.3 billion suggests that perhaps the largest cost overrun

7. *Id.* at p. 577.

in the history of a privately financed business venture may have been attained.

Once the Commission has received the Touche Ross report, it must then investigate the problems uncovered by the report in an open forum. The report and the investigation could have a direct and significant bearing on the reasonableness of the proposed rates. Clearly, no rate should receive even the tacit approval of this Commission until it has thoroughly considered the full record regarding the cost overruns.

3. *Conditions Requiring The Production of Documents Must Be Added To The Permission To File Temporary Rates To Protect The Integrity Of The Investigation*

We have found that the companies and Alyeska have not supplied all relevant documents that they have on file describing among other things the planning, construction progress, and cost controls, that are the subject of the Touche Ross contract. Touche Ross has met with resistance to meaningful disclosure of records, and has relatively little of the relevant owner company records.

Touche Ross reported the following in a letter to the Commission's Bureau of Accounts of May 27, 1977[8]:

> It is abundantly clear from our various conversations that procedural access problems are a long way from being resolved. It further appears that access through Alyeska to third-party documentation and/or personnel is far from resolution. Access problems with regard to third parties may have to

8. "CMC" refers to Construction Management Contractor. "EC" refers to Executive Contractor. "OM&M" refers to O'Melveny & Myers.

be resolved separately, with eight separate Owner companies, the individual CMCs and ECs.

To date we have presented approximately 400 document requests. Of these approximately 175, representing about 2,500 separate documents have been received. OM&M has asserted the attorney/client priviledge [sic] on 101 documents and, in addition have not supplied documents for the following reasons:

Not locatable, missing, do not exist, wrong identification number.	18
Temporarily withheld.	4
Documents on microfiche—available for later review.	54
	76

The delay in resolving the issues raised in our May 12 meeting indicates that the access situation has not changed and may well deteriorate as we press for increased amounts of specific information. We believe that the current situation does raise some doubts about the practicality of our proposed comprehensive analysis approach in the time frame currently planned. The access situation, in our view, should be monitored closely during the next two to three weeks to determine an appropriate course of action for the project.

The owner companies have placed an unwarranted burden on Touche Ross to identify specific documents. We believe that Touches Ross should be permitted to see broad categories of documents, and that Alyeska and the owning

companies should not be permitted to impede that important study.

Consequently, we urgently request the Commission to attach to its I. & S. order both a permission to file on the lower basis described later in this Protest and a condition that the refiling is permitted upon the agreement of the owning companies to submit for the Commission's inspection and copying the records and documents listed in Appendix D hereto.

Clearly, if Touche Ross is to provide this Commission with a meaningful study of the cost overruns that have plagued the TAPS project, it must have access to all relevant documents and related personnel. Its efforts, we submit, are being frustrated and delayed, and the Commission now has the opportunity, which may not present itself again, to reverse these delays.

We suggest that the documents described in item 24(c) be submitted upon the refiling of the tariffs at the lower rate level. We further suggest that the Commission require the submission of the remaining documents within a period of 30 days in accordance with a schedule to be agreed upon by this Bureau and counsel for the companies.

4. *Commission Possesses Jurisdiction to Suspend with Permission to Refile at a Lower Level*

We shall show later herein that all the rates that have been proposed by the carriers at levels exceeding $6.00 per barrel should be suspended, since they are prima facie unreasonable. However, some rates must be filed to permit the pipeline to operate pending the investigation. We will show that rates ranging from $4.54 to $5.00 constitute proper rates for this purpose. In summary, the Commission must consider conditioning the suspension order with

permission to refile lower rates on short notice in order to allow the transportation to commence.

Suspension power. Under Section 15(7) of the Interstate Commerce Act, 49 U.S.C. §15(7), the Commission is empowered to enter upon a hearing whenever a "new" rate if filed, and pending such hearing and decision thereon to suspend the operation of "such schedule" for up to seven months.[9] If the Commission suspends and the hearing has not been concluded in the seven-month period, the carrier can make its proposed rate effective.[10] Since the suspension power applies to any "new" rate, the Commission has long and continuously held that it applies both to changed and to initial rates.[11]

We briefly note in passing that the tariffs that were extended voluntarily from June 20 to June 30 continue to be initial rates subject to the suspension power. Once previously filed rates have been canceled by a carrier under special permission before becoming effective, the next filed rates become the initial rates subject to the suspension power.[12]

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9. See also Section 216(g) of the Act, 49 U.S.C. § 316(g).

10. The Commission has not distinguished between changed and initial rates here. The statute provides that only a changed rate automatically becomes effective as a matter of law at the expiration of the seven-month period. The Commission could, although we are not aware that it ever has, require a carrier filing initial rates to *move* to make them effective at the end of the seven-month period as the Federal Power Commission has done (see Appendix H hereto).

11. Among the many cases in which initial rates have been suspended are the following: *Machinery from Salt Lake City—International Transport, Inc.*, 304 I.C.C. 286 (1958); *Clay from Greybill, Wyo., to Points in the Middle West*, 314 I.C.C. 705 (1961); *Animal Feed from Mississippi and Tennessee to Midwest and Southwest*, 316 I.C.C. 94 (1962); *Foodstuffs & Agricultural Commodities, Calif., & Ariz., to West & South*, 329 I.C.C. 321 (1966); *Animal Food, Middlewest to California, Idaho, and Utah*, 332 I.C.C. 87 (1967).

12. *E.g. Dicalcium Phosphate from Bonnie, Fla., to Various States*, 314 I.C.C. 632 (1961).

Permission to refile on a lower basis. In the suspension order, the Commission should advise the carriers that it will not suspend initial rates that equal demonstrated costs and that its order of investigation will encompass the lower rates filed by the carriers in response to the suspension order. The carriers will thereby obtain the option of filing at a lower level and participating in the investigation on that basis, or awaiting the expiration of the suspension period to make their proposed rates effective and participating in the investigation on the basis of those rates.

The Commission has often permitted the refiling on a lower basis pending the proceeding when proposed rates were prima facie unreasonable.[13] Such a permission is not a prescription of rates. To make this even more clear, the Commission should include a statement in its order that it is not prescribing rates within the meaning of *Arizona Grocery*.[14]

The order we here recommend would also avoid the procedural problems encountered by the Civil Aeronautics Board in the *Moss* case.[15] The Court of Appeals there reversed the Board's decision indicating to the carriers that a specified level of rates would not be suspended or investigated. Unlike *Moss*, the Commission here would in no way prejudge the outcome of its investigation of the lower rates.

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13. The practice is most common in general increase cases. *See, e.g.*, Ex Parte No. 259, *Increased Freight Rates, 1969*, 332 I.C.C. 590, 594-95 (1968).

14. *Arizona Grocery* v. *Atchison, T. & S.F. Ry.*, 284 U.S. 370 (1932).

15. *Moss* v. *Civil Aeronautics Board*, 430 F. 2d 891 (D.C. Cir., 1970).

5. *Temporary Rates Ranging from $4.54 to $5.00 for Individual Carriers are Justified and Should be Permitted on One Day's Notice*

In the "Background" section of this Protest, we suggested that consistent with the absence of antitrust immunity, the six tariffs separately present the question of the appropriate interim rates pending the investigation into the cost and valuation of the pipeline. We, therefore, propose to recommend a group of six rates ranging from $4.54 to $5 that the Commission should permit to become effective on one day's notice, and to serve as the basis for its investigation into the cost and valuation issues.

Even if the Commission accepts all the carrier's original construction cost figures in this interim period pending the investigation, it should not allow any rates higher than presently needed to cover the reasonably estimated costs plus fair return. Temporary or interim rates as high as we here recommend are likely to be found too high once the Commission has investigated, among other things, the numerous cost overruns. Rates ranging for the individual companies from $4.54 to $5, therefore, will necessitate the inclusion of a refund provision in any order authorizing their filing.

There are five basic elements of the pipeline rates that must be considered before the Commission can decide whether to suspend the published rates or any others that may be filed, namely,

(a) Operating costs.
(b) Depreciation.
(c) Removal costs.
(d) Return on valuation.
(e) Federal and State income taxes.

Let us then briefly consider each one.

Operating costs. The carriers have proposed operating costs that average 93 cents per barrel. This figure compares to the following projected figures used in other published studies:

Mortada study[16]	78¢
Drexel-Burnham[17]	51¢
Wainwright[18]	73¢

The proposed operating costs per barrel assume a throughput of only 1.2 million barrels per day. Most studies we have seen reflect an increase to 1.6 million barrels by about 1980.[19] Arco advises us that, (1) it uses a 4.3 year average flow for the initial tariff, and (2) it expects to attain 1.6 million barrels per day by mid-1980. For the first 4.3 years, Arco's average flow rate will be about 1.3 million barrels/day. Moreover, the carriers' average figure of 93¢/B requires investigation since it may reflect further cost overrun. For purposes of an interim rate only, we recommend that the Commission use the carriers' proposed figure of 1.2 million B/day, and operating expenses projected by each carrier.

Depreciation.[20] The carriers propose average depreciation and amortization of 83¢ per barrel based on investment,

16. "The Determination of Equitable Pricing Levels for North Slope Alaskan Crude Oil" prepared for FEA by Mortada International, Dallas, Texas (November 1, 1976). A copy of Chapter IV of this Study is attached hereto as Appendix E for the information of the Commission. See pp. IV-19 and IV-23 of that Study, which refers to 52¢ for operations and an additional 26¢ for property taxes.

17. "The North Slope: Paradise Lost? An Industry Analysis." Drexel Burnham & Co., Inc., April, 1976, Table II-B for 1978.

18. "Petroleum Industry," Wainwright Securities, Inc., April 1, 1977, Table 10, or 40¢ for operations and 33¢ for property taxes.

19. For example, see Mortada study, App. E hereto, at p. IV-20.

20. Including amortization of overhead and capitalized interest during construction at 6 percent.

excluding land, of $9.280 billion and a service life of 25 years. In later pages, we show that a 25-year life is too conservative, even for interim rates, and that the Commission should use not less than 27.5 years as the projected service life. For a service life of 27.5 years, the annual average depreciation and amortization is 77¢/barrel,[21] which should then be apportioned to each carrier in accordance with its percentage of ownership.

Removal costs. The carriers report that they commissioned a study of the costs of removing the pipeline and restoring the surface. We have not seen this study, but it nevertheless raises certain conceptual questions that we later discuss. The carriers advise that the study projects a one-time cost, 25 years hence, of $1.049 billion, which some of them adjust for inflation. If amortized over 25 years, the annual average cost in 1977 dollars becomes 9.6¢ per/barrel. Consistent with our treatment of depreciation expense in this interim period, we recommend the use of a 27.5-year life, and hence amortize the removal costs in current dollars on the basis of 8.7¢/barrel,[22] which also may be apportioned on the basis of percent ownership.

Return on valuation. The fair return on valuation standard to compensate both the debt and the equity holders in the pipeline carriers is now under review in Ex Parte No. 308 (Sub-No. 1). We recommend that those standards be explored as well in this proceeding in the context of the particular circumstances surrounding the construction of this pipeline.

We will later show that the very high rates exceeding $6 that are proposed here seem to reflect an irrational allowance of the *entire* return on valuation as a return

21. ($9.280 billion ÷ 27.5 years) ÷ 438 million barrels.

22. ($1.049 billion ÷ 27.5 years) ÷ 438 million barrels.

solely for the stockholders. Only in this way can we understand the total returns of over $2 for equity and $1.59 for interest, which the carriers seemed to propose.

In the meantime, we recommend that the Commission employ a 10 percent return on valuation as it has historically been computed without prejudice to reconsidering the various elements of value that enter into the rate base computation. We recognize that the Commission has relied in the past on an 8 percent return on valuation for crude oil pipelines.[23] Use of that standard here, however, would limit the return on equity to less than 6 percent. A return on valuation of 10 percent comports with the results of recent studies we have seen on the TAPS initial tariff rates, as follows.[24]

	Tariff Rate (¢/B)	Returns for (¢/B)			Implied Percent of Valuation
		Debt	Equity	Total	
	(1)	(2)	(3)	(4)	(Col. 4 ÷ 2225)[25]
Mortada	450	157	72	229	10.3%
Drexel-Burnham	460	149	83	232	10.4
Wainwright ...	423	160	56	216	9.7

An original cost rate base would amount to about $9.295 billion, including $9.28 billion for improvements and $15 million for land, if we accept for present purposes the entire construction cost without adjustment for cost overruns. The valuation becomes $9.747 billion once reproduction cost and other elements of the valuation are

23. *Minnelusa Oil Corp.* v. *Continental Pipe Line Co.*, 258 I.C.C. 41, 53-54 (1944).

24. For references to the sources of these figures, see Appendix A hereto, p. 3.

25. 2,225¢/B based on $9.747 billion ÷ 438 million B/yr.

included. Consequently, a 10 percent return is equivalent to an annual cost of 222¢/barrel.[26]

Federal and State income taxes. For many years, the Commission has recognized only actual taxes, rather than imputed or "normalized" taxes in its rate cases. In the *Williams* case,[27] it allowed normalized taxes. We recommend that the Commission use normalized taxes on an interim basis until the actual tax rates can be determined. The Commission should expressly recognize that such taxes will not be paid at least in the forseeable future. They, therefore, provide a substantial cushion in the interim rates that in themselves warrant the addition of a refund provision in the order.

"Normalized" taxes here refer to the statutory Federal rates of 48 percent and the State of Alaska rate of about 9.4 percent. Since the State tax is deductible for Federal purposes, the effective overall income tax rate on a normalized basis is 52.9 percent. The normalized tax computation follows:

1. Return on valuation	222¢/B
2. Less deductible interest	159
3. Return for equity after taxes	63
4. Equivalent percent (100%-52.9%)	47.1%
5. Return for equity before taxes (line 3 ÷ line 4)	133.8¢/B
6. Income taxes (line 5 − line 3)	70.8¢/B

26. ($9.747 billion x 10%) ÷ 438 million barrels. We do not mean to suggest that reproduction cost will increase the valuation once the original cost investigation has been concluded, or that the concept of reproduction cost will ultimately have any application here.

27. *Petroleum Products, Williams Brothers Pipe Line Co.*, Docket No. 35533, decided by the entire Commission on reconsideration December 3, 1976.

Summary. Based on the foregoing, the average interim rate becomes $4.72 based on the following average costs:

Operating costs	93¢/B
Depreciation	77
Removal costs	9
Return on valuation	222
Income taxes	71
Avg. interim rate	432¢/B

The carriers have reported to the Bureau of Accounts that their interest costs in 1978 will be $695 million (see App. A hereto), or less than 159¢/B, leaving 63¢/B for equity. Since equity comprises less than 15 percent of capitalization, the equity component is about 318¢/B,[28] and the return for equity under the recommended interim rate will average a generous *20 percent after taxes.*[29]

On the other hand, as we explained earlier, we do not recommend that the Commission employ an average interim rate. The maximum interim rates justified for the individual carriers are shown below:

Carrier	Percent Ownership	Total Costs & Return[30]	Max. Interim Rate (¢/B) (col. 2 ÷ col. 1) ÷ 438 mill.
	(1)	(2)	
Sohio	33.34%	$ 662.5	454
ARCO	21.00	446.3	485
Exxon	20.00	438.2	500
BP	15.84	318.5	459
Mobil	5.00	105.2	480
Union	1.66	36.3	499
Phillips	1.66	35.3	486
AmHess	1.50	30.2	460
Totals	100.00%	$2,072.5	473[31]

28. (15% x $9.295 billion) ÷ 438 barrels = 318¢/B.

29. 63¢ ÷ 318¢ = 19.81%. The carriers' average cost of debt is 8.8 percent (*i.e.* $695 million ÷ (85% x $9.295 billion).

30. Appendix A, p. 1. Figures are in millions of dollars.

31. Differs from $4.72 due to rounding.

Consequently, interim rates of $4.54 to $5.00 protect the carriers, prevents exorbitant returns in an interim period, and, when combined with a reasonable refund provision, also protects the shippers and other interests affected by the rates.

6. *Proposed Rates Exceeding $6.00 Should Be Suspended, Since the Carriers Greatly Overstate Costs*

a. Carriers Overstate Depreciation

The carriers use a 25-year life to amortize the construction costs and capitalized interest associated with TAPS. For the original cost of $9.2 billion, including capitalized interest of $1.3 billion, the carriers project average depreciation and amortization expense of 84 cents per barrel.[32] Since the carriers have understated the life of the pipeline by failing to use at least a 27.5-year life, they have overstated this expense.

In the FPC Recommendation of May 1, 1977, that commission found, as follows (at p. III-19):

> Natural recovery mechanisms (without the injection of produced water) should result in recovery of from 32% to 35% of the original oil in place (OOIP). *This oil recovery should be achieved over a period of 25 to 30 years.* (emphasis added)

The FPC relied on, among others the Van Poolin study (see Appendix B hereto) which describes a similar range.

One of the basic studies of oil and gas production presented on that record was Exhibit EP-53, a three-dimensional computer model, sponsored by El Paso Alaska Company. That study as described by the administrative law judge, estimated deliverability of oil from the main area over a period of 28 years.[33]

32. ($9.2 billion ÷ 25 years) ÷ 438 million barrels per year. The latter figure assumes an average flow-rate of 1.2 million barrels per day.

The range of 25 to 30 years also corresponds to the so-called "Mortada Study" prepared for the Federal Energy Administration in 1976. In that study, FEA's consultant assume 26.5 years for the life of TAPS for tariff computation.[34]

Other studies have relied on much longer periods of life for TAPS. For example, in a financial study of TAPS by Wainwright Securities, Inc.[35] earlier this year, the operating life of 35 years was used (at p. 40) to compute a tariff rate of $4.23 and TAPS' potential earnings. None of these studies increase service life to account for production in fields adjacent to the main one for the purpose of the tariff computations.

The carriers, therefore, have chosen the lowest pipeline service life over which to depreciate and amortize costs. We believe the mid-figure (*i.e.* 27.5 years) of the conservative range found by the FPC is more reasonable for purposes of the present initial rates than the low end chosen by the carriers. There are definite indications that such mid-figure is a minimum figure; and that following investigation, a longer life will be shown for TAPS.

b. Carriers Overstate Removal & Restoration Costs

The same problem of useful life inheres in the carriers' proposed annual accrual to cover the projected one-time

33. See Initial Decision in El Paso Alaska Company, Docket No. CP 75-96, Feb. 1, 1977, p. 29.

34. Appendix E hereto, p. IV-19. The FPC also relied on this study. See Recommendation, p. III-B-1.

35. Wainwright study, *supra*, at p. 40.

cost of at least $1.049 billion to remove the pipeline and related facilities and to restore the surface to its former state at the end of the service life of the pipeline, or what has also been termed TAPS' "negative salvage value." Assuming a 25-year life, the carriers seek to recover the one-time future expense over a period of 25 years, and hence seek to charge the shippers at least $41.96 million per year or 9.6 cents per barrel per year.

On the other hand, the carriers differ among themselves over how much should be amortized with at least one carrier claiming total removal and restoration costs, including 25 years of compounded inflation, of over $4 billion. The differing estimates submitted by the carriers are set forth below:

	($ Millions) Annual Amount of Removal Costs Reported to Bur. of Accts.	Percent of Total	Total Cost Assumed by Carrier (Col. 1-Col. 2) x 25 Years
Amerada Hess	$ .629	1.50%	$ 1,048
Phillips	.6965	1.66	1,049
Sohio	14.0	33.34	1,050
Union Alaska	.697	1.66	1,050
BP	7.178	15.84	1,133
Arco	13.2	21.00	1,571
Exxon	16.4	20.00	2,050
Mobil	8.513	5.00	4,257

At the outset, we have doubts that all these monies will be used even in 1977 dollars, or that it is fair to begin collecting such sums so early. Under the Agreement and Grant of Right-of-Way between the Department of the Interior and the carriers of January 23, 1974, the carriers are obligated to rehabilitate property or a natural resource

that has been "seriously damaged or destroyed" (para. 13A), which is yet to be defined. The carriers are not obligated even on termination to rehabilitate any area affected by an act of war or negligence or willful misconduct of others using the property (*Id.*).

The qualifications to the carriers' alleged liability to rehabilitate must obviously be taken into account in an investigation before shippers are required to provide full indemnity, and allowance must be made by the Commission for these important factors. In such matters, it would not be consistent with shipper interests to resolve all doubts in favor of higher tariff rates.[36] The interim rates in the meantime should reflect no greater amortization than the $1.049 billion over 27.5 years.

7. *Proposed Rates Exceeding $6.00 Should Be Suspended Since the Carriers Overstate Their Revenue Need*

We have reproduced in Appendix A, p. 2, hereto the expense figures supplied to us by each of the pipeline carriers. We have not received actual costs of equity figures. Nevertheless, we are convinced that in no case would the total expense column, including return, reach the over six-dollar tariff rates that are the subject of this protest.

We must surmise how the carriers reach such high tariff rates. We need not look long, however, for it seems the parent companies have represented to the FPC that this Commission will allow the carriers' equity holders to retain the entire return on valuation, and that interest expense must be accounted for separately as an "operating expense."

36. See *Bebchick* v. *Public Utilities Commission*, 318 F.2d 187, 192-94 (D.C. Cir. 1963), cert. denied, 373 U.S. 913, involving a track removal and repaving obligation of a bus company.

For example, the parent companies of these carriers represented to the FPC in the recently concluded gas pipeline case that the ICC would generously allow them *30 percent* returns on equity, as follows:[37]

> The only comparable project of the size and complexity discussed herein that has received private financing is the Alyeska oil pipeline. If that line receives the usual ICC treatment of allowing a 7-8 percent rate of return *after taxes and interest* on ICC valuation (i.e. total assets), and a 75/25 debt to equity ratio is assumed, the after-tax return on equity would be in the 28-32 percent range. (emphasis theirs).

The FPC refused to accept such an expectation as any reasonable estimate of the cost to attract capital to the pipeline industry:[38]

> Since, however, the major consideration of the oil producers, who were the ones to finance the oil pipeline, was to get the oil to market, it is difficult to draw any conclusions regarding the rate of return on their pipeline investment they "required" in order to finance it.

The FPC considered instead the actual profitability and financial structure of the integrated petroleum companies. It found that in the 1966-1975 period on average the companies earned 11.8 percent after-tax on equity, and during the three-year period 1973-1975, earned an average after-tax return on equity of about 14.8 percent.[39]

37. FPC Recommendation, *supra*, at p. XII-45. The FPC allowed 18% on equity, after taxes, which it reduced to 11% if cost overruns should become excessive.

38. *Id.*

39. *Id.* We have attached as Appendix F hereto the Chase Manhattan Bank financial statistics for the group of 28 petroleum companies on which the FPC relied (*i.e.* App. XII-A of the Recommendation).

Aside from a bare table of figures in the recent *Williams Brothers* case,[40] where the matter was not discussed, we fail to find any other reported pipeline rate case that awards the entire return on valuation to the equity holders of the pipeline. On the contrary, we find indications that "the usual ICC treatment" of this matter is to allow the return on valuation to cover the pipeline's total cost of capital, that is, both long-term interest and all payments to stockholders.

For example, in *Reduced Pipe Line Rates and Gathering Charges*, 243 I.C.C. 115 (1940), the Commission on its own motion entered into a general investigation in 1934, which, as subsequently broadened, included all the rates, rules and practices of 37 carriers by pipe line. The Commission served the respondents with a questionnaire requiring the submission of financial, property and rate data for a 5-year period; later years were added in the reopened proceeding.

For the year 1935, the last full year for which the Commission had data, it computed the excess earnings of the carriers over an 8 percent return on value in a seven-column appendix (at p. 148). The columns were headed as follows:

1. Transportation revenue.
2. Transportation expense including depreciation and taxes.
3. Earnings or excess of revenue over expense.
4. Value of property used.
5. Return on value.
6. Earnings needed to return 8 percent on value.
7. Excess actual earnings over 8 percent return.

It is significant here that "transportation expense" (col. 2) excluded interest, which was to be covered by "earnings or

40. Docket No. 35533, *Petroleum Products, Williams Brothers Pipe Line Company, supra*, esp. at p. 16.

excess of revenue over expense" (col. 3) and hence by the return on value (col. 5). To show that this was in fact the Commission's method of calculation, we have recomputed the "transportation expense" figures in the *Reduced Rates* table for 5 carriers from reported figures for 1935 that are known to exclude interest.[41] They equal the expense figures that the Commission relied on in Appendix D.

Pipeline Co.	Interest on long-term debt	Transp. Expense[42] (excluding interest)			Transp. Exp. in App. D
		Operating	Taxes	Total	
(1)	(2)	(3)	(4)	(5)	(6)
Arkansas Pipe Line Co.	24	219	120	339	339
Gulf Pipe Line Co. of Pa.	133	971	760	1,731	1,731
Pure Transportation Co.	1,086	1,443	621	2,064	2,064
Shell Pipe Line Corp.	1,208	7,157	1,876	9,003	9,034
Tide-Water Pipe	10	486	181	667	667

Accordingly, the long-standing practice of the Commission in fact has been to include interest as an element of the return on valuation for pipelines.

It cannot logically be otherwise. The rate base includes the entire investment in used and useful property; and the rate of return is developed from the costs of the entire capital devoted to the enterprise. The "capital costs of the

41. See Transport Statistics, 1935, p. S-161. The figures for three other carriers are impossible to reconcile with the Appendix D data; the figures of at best one other carrier include interest.

42. *Id.*

business . . . include service on the debt and dividends on the stock."[43] As Prof. Westmeyer has succinctly stated:[44]

> In other words, a fair return must be sufficient to enable the railroad industry [or other mode of carriers] to maintain its credit by making regular payments at acceptable rates of interest on its fixed obligations, and if there is any expectation of financing improvements by the sale of stock, an acceptable rate of dividends must be paid as well.

It appears that TAPS will be capitalized with about 15 percent equity and 85 percent debt. Since a 10 percent return on valuation is equivalent to 222¢/B, and 15 percent of the original cost is equivalent to 318¢/B,[45] the allowance of the entire return on valuation to the stockholders means an effective return on equity of *70 percent*.[46]

It is true that in 1941 most of the owning companies signed a consent decree with the Department of Justice placing a restriction on dividends of 7 percent of valuaton.[47] In 1957 the Department of Justice brought a suit contending that the carriers' payment of 7 percent of valuation to their stockholders did not result in a "fair" dividend. The Supreme Court held that, nevertheless, the parties to the decree had so agreed, and the Court could not read the decree differently,[48]

43. *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

44. Westmeyer, Russell E., *Economics of Transportation*, Prentice-Hall, Inc., p. 208 (1956).

45. (15% x 9.295 billion) ÷ 438 million B/yr.

46. 222¢ ÷ 318¢ = 69.8%.

47. *United States* v. *Atlantic Refining Co.*, C.A. No. 14060, D.D.C. decided December 23, 1941.

48. *United States* v. *Atlantic Refining Co.*, 360 U.S. 19, 24 (1959).

> simply because another reading might seem more consistent with the Government's reason for entering into the agreement in the first place.

As we next show, (1) the dividend restriction was worded the way it was apparently because the pipeline industry in 1940 had virtually no long term debt, and (2) that with so much debt capital having replaced the equity capital of the carriers, a dividend restriction now provides no standard for a fair return.

In Appendix G hereto we have reproduced Table 6 from the Verified Statement of David L. Jones, an economist and witness for this Bureau in Ex Parte No. 308, *Valuation of Common Carrier Pipelines.* The last column of that table shows that in 1940, the funded debt of the oil pipeline industry was merely *10 percent* of total capitalization. Consequently, in 1941, the Department no doubt believed that in those circumstances a dividend restriction of 7 percent of valuation provided an effective limitation on both earnings and payout, although worded only in the form of a restriction on payout. It apparently took the industry about five years to discover that a higher debt/equity ratio would permit their lawfully circumventing the decree.

Appendix G shows that by the mid-forties the industry began to shift from a low debt/equity ratio to a high one. In this way, the oil companies could reduce equity investment and convert an overall 7 percent return, that resulted from the payout restriction, to a much higher return on equity.

For example, let us assume that in 1940 the valuation was equal to capitalization. The changes that occurred in the debt/equity ratio over the years produced the following increases in the return on equity in the absence of any effective protests or complaints before this Commission:

Year	Capitalization		Effective Return on Equity at 7% of Valuation
	Percent Debt	Percent Equity	
1940	10%	90%	7.7%
1950	64	36	19.4
1960	73	27	25.9
1970	82	18	38.9
1975	93	7	100.0

The consent decree has been treated as purely a dividend restriction by the pipeline companies, and exploited to produce large returns on equity. The consent decree payout limitation is clearly no standard for just and reasonable earnings on equity, and should not be followed by this Commission in this proceeding.

The Commission should not accept, even on a temporary basis, rates like those proposed in the subject tariffs that are premised on granting the entire return on valuation to the carriers' equity holders.

8. *Any Order Permitting Interim Rates Ranging From $4.54 to $5.00 Should Include a Condition Providing for Possible Refunds*

We have shown that rates ranging from $4.54 to $5.00 will leave substantial room for investigation into the maximum reasonable level. Users of the pipeline, therefore, should receive a refund, if it is later held that the filed rates are unjust or unreasonable.

Section 15(7) of the Act expressly provides for refunds of "increased" rates. An initial rate has been "increased" only in the sense that there has been a change from zero to some number. Thus, the Commission's jurisdiction to order a refund of an initial rate is not clear in the statute, although it is clear that the Commission would have jurisdic-

tion to award reparation, if the initial rates were found unreasonable.

The Commission should now simplify the shippers' remedy to obtain a refund. An express refund provision would operate automatically,[49] as well as protect the Commission's jurisdiction to accomplish that simplification. The inclusion of an express refund provision and other conditions now would grant the carriers the option of refiling at the lower basis subject to such conditions, or awaiting the expiration of the seven-month suspension period for their originally filed rates to become effective.

Close in point is *United States* v. *Chesapeake & Ohio R. Co.*, 426 U.S. 500, 49 L. Ed. 2d 14 (1976), sustaining the Commission's conditional no-suspend order in Ex Parte 305.[50] Just as in that proceeding, the Commission here could simply suspend the rates for the full seven-month period; but, the Ex Parte 305 conditional order is also available as an alternative. As the Court continued (49 L. Ed. 2d at 23-24), the Commission,

> pursued a more measured course and offered an alternative tailored far more precisely to the particular circumstances presented.
>
> • • •
>
> They [the carriers] had the option to continue to insist on an unconditional increase, to submit proof of their reasonableness to the Commission and, if successful, or if the investigation were not completed within the statutory seven-month period, to collect rates based on the new tariffs.

49. *See Increased Freight Rates, 1969*, 337 I.C.C. 436, 438 (1970).

50. *Nationwide Increase of Ten Percent in Freight Rates and Charges, 1974*, decided August 9, 1974.

There is a further jurisdictional basis for a refund condition here, since it is tantamount to the exercise of express statutory authority to grant reparation. Under Section 16 of the Act, 49 U.S.C. § 16, the Commission is directly authorized to grant an "award of damages" upon the filing of a complaint. The protests that are being filed today are equivalent to complaints, since the protestants in this case, unlike the typical increase proceeding, undertake the burden of proof.[51] Consequently, a refund condition here merely serves as notice in advance that the Commission will award damages if the protestants fulfill their burden of showing that the new rates made effective by the pipelines are unreasonable.

There was a dissent in the *C&O* case on the grounds among others that the conditional rate increase in Ex Parte 305 was intended to effectuate policies that were unrelated to the maintenance of "the integrity of the ratemaking process" (49 L. Ed. 2d at 31). The present case for a conditional rate increase, therefore, is stronger than in Ex Parte 305 for the further reason that the need for conditions here lies at the heart of the entire ratemaking process for new pipeline rates. A suspension of the rates for seven months here does not merely postpone increases, but rather stops all operations, and hence some rates must be allowed. Unless the Commission can order refunds, it will be completely thwarted in exercising any effective ratemaking power for the pendency of the proceeding.

Also in point is *Admiral-Merchants Motor Freight, Inc.* v. *United States*, 321 F. Supp. 353 (D.C. Colo. 1971), *aff'd* 404 U.S. 802, sustaining a refund provision attached by the Commission as a condition to its allowing an extension of

51. We distinguish burden of proof from burden of going forward. The carriers possess the latter burden, since they are also the sole possessors of much information and data relevant to the issues.

time in the context of a motor carrier case, where it had no direct statutory authority to grant refunds. As the District Court stated, the order in question "was not unlike the exercise of the suspension power" (at 359). When the carriers accepted the benefits of the extension of time and withdrew their objection to the refund condition, the Court held that the carriers might not later renege on making refunds (at 359-60).[52] But, as we have shown, the Commission's jurisdiction to add a refund provision here goes beyond the mere grant of a benefit to the carriers, and hence presents a stronger case for the exercise of that power than in motor carrier cases like *Admiral-Merchants.*

Interest. Refunds of rates later found to be excessive should be ordered with compounded interest at 9 percent per year. Section 15(7) specifically refers to interest without any reference to the rate of interest. The Commission has often used a rate of 4 percent; but that rate was first adopted in 1946,[53] and has outlived its relevance. In fact the prime rate in 1946 was less than 2 percent in New York City.[54]

The experience of the Federal Power Commission with pipeline refunds is instructive. The current rules of the FPC prescribe automatic accounting and refund provisions with interest at *9 percent,* when increases are made effec-

52. Such an order may be enforced at the suit of individual shippers (see *Aluminum Co. of Amer.* v. *Admiral Merchants M. Freight,* 486 F.2d 717 (7th Cir. 1973), cert. denied, 414 U.S. 1113; *S.S. Kresge Co.* v. *A&B Transfer, Inc.,* 488 F.2d 894 (6th Cir. 1973), cert. denied, 415 U.S. 960. Or, it may be enforced in a class action. See *Appleton Elec. Co.* v. *Advance-United Expressways,* 494 F.2d 126 (7th Cir. 1974).

53. See *Christensen Bros. Feed Co.* v. *Great Northern Ry. Co.,* 303 I.C.C. 45, 46 (1958).

54. 33 *Federal Reserve Bulletin* 63 (Jan. 1947).

tive by natural gas pipeline companies at the expiration of a suspension period. A copy of the relevant rule, which also includes a form of "agreement and undertaking" that must be signed by such companies when making suspended rates effective,[55] is attached as Appendix H for the convenience of the Commission.

9. *Rules and Regulations in the Proposed Tariff May Be Unreasonable and Anti-Competitive*

Several of the rules and regulations in the proposed tariffs may violate prior holdings of this Commission, or are otherwise unlawful, and should be investigated.

Minimum Tender. The BP tariff requires the tender of at least 30,000 barrels over a thirty-day period from one shipper consigned to one consignee and one destination (Rule 6). The Amerada Hess tariff requires a minimum tender of 5,000 barrels (Rule 4); and the Sohio tariff, 10,000 barrels (Rule 25). The minimum of 10,000 barrels may be met by two or more shippers to a common consignee under the Mobil Alaska tariff (Rule 19).

In *Reduced Pipe Line Rates and Gathering Charges,* 243 I.C.C. 115, 136 (1940), the entire Commission found that a 10,000-barrel lot is as large as it could find reasonable to serve as a minimum tender, and that any higher minimum would be unreasonable.[56] The Commission noted that the large refiners can meet a large minimum-tender require-

55. 18 CFR 154.67. FPC Order No. 513-A issued in *Rate of Interest on Amounts Subject to Refund,* Docket No. RM74-18, July 14, 1976, *expands* the application of the 9 percent rate in accordance with the opinion of the Court of Appeals in *American Public Gas Ass'n* v. *Federal Power Comm.,* 546 F.2d 983 (D.C. Cir. 1976).

56. *Cf. Restrictions on Service by Motor Common Carriers,* 126 M.C.C. 303, 324-25 (1977), proscribing unreasonable minimum weight requirements.

ment "without difficulty" (*Id.*); but smaller refiners could have difficulty.[57]

Minimum Delivery. Unlike the other pipelines, the ARCO tariff (ICC No. 1030) provides: "Carrier will not make a delivery of less than 100,000 Barrels of Petroleum at destination point on its Pipeline except when necessitated by dispatching contingencies." The provision excludes using a smaller vessel, if the larger one is unavailable. The Commission in the *Reduced Rates* case characterized a similar rule as just another form of minimum shipment (272 I.C.C. at 382).

Carriers' Liability. All the carriers proposed rules limiting their liability for, among other things, loss of petroleum and failure to receive or deliver petroleum.[58] These provisions seem inconsistent with the requirements of Section 20(11) of the Act, 49 U.S.C. §20(11), rendering a common carrier liable for full actual loss, damage or injury and declaring any limitation of liability "unlawful and void."

Penalty Provisions. Rule 45 of Sohio's ICC No. 742, provides a series of penalties for the shipper's violation of the carrier's rules for efficient scheduling and use of the Valdez Terminal. For example, in paragraph (E), the rule imposes a 20-cent per barrel penalty on those barrels "by which Carrier's Working Inventory exceeds the Carrier's Working Capacity." Then in paragraphs (G) and (H)

57. The decision on this point was later affirmed on further hearing (272 I.C.C. 375, 382-83 (1948).

58. Amerada-Hess, ICC No. 2, Rules 15-17; BP's ICC No. 1, Rules 16-18; ARCO's ICC No. 1030, Rules 14-15; Sohio's ICC No. 742, Rules 60, 65 and 70; Mobil Alaska's ICC No. 1, Rules 11-13.

5-cent penalties are provided. The others have similar provisions.[59]

Demurrage. BP's ICC No. 1, Item 11, provides for heavy demurrage charges ($2,000 per *hour*) for vessels operating at Valdez; the same provision is found in Amerada Hess' ICC No. 2, Item 8.

These rules and others should be included in the investigation order.

CONCLUSION

We respectfully request the Commission to enter an order of investigation and suspension relating to the six filed tariffs and others that may be filed in excess of the interim levels here recommended.[60] The Commission should incorporate a proviso in its order, to the effect that special permission is granted to cancel the proposed rates, and to file and to make effective the following rates on not less than one day's notice pending the hearing and decision in the ordered investigation:

Filing Carrier	Permitted Interim Rate
Sohio	454¢ Lb.
Arco	485
Exxon	500
BP	459
Mobile	480
Union Alaska	499
Phillips	486
Amerada Hess	460

59. *E.g.* ARCO's ICC No. 1030, Item 7; BP's ICC No. 1, Item 10; Amerada Hess' ICC No. 2, Items 8, 9, 10; Mobil Alaska's ICC No. 1, Rule IV.

60. The two carriers that have not yet filed are Union Alaska Pipeline Company and Phillips Petroleum Company.

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We further request that the Commission condition the foregoing proviso with the requirement that each carrier that files an interim rate thereunder shall expressly consent to keep account of all rates and charges collected during the period of the investigation, and thereafter refund any sums ordered by the Commission following the conclusion of its investigation.

We also request that the Commission condition the foregoing proviso with the requirement that each carrier filing an interim rate thereunder shall expressly consent to comply with the request for documents set forth in Appendix D hereto within 30 days from the date of the order upon a schedule to be agreed between such carrier and counsel for this Bureau.

Respectfully submitted,

PETER M. SHANNON, JR.
Director

EDWARD D. GREENBERG
Special Counsel for Pipelines

Bureau of Investigations and
Enforcement
Interstate Commerce Commission
12th and Constitution Avenue, N.W.
Washington, D.C. 20423

Of Counsel:
LEONARD S. GOODMAN
7119 Sixteenth Street, N.W.
Washington, D.C. 20012

[Certificate of Service omitted in printing]

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Appendix A
Page 1 of 4

TRANS-ALASKA PIPELINE SYSTEM
OPERATING EXPENSES, DEPRECIATION, INTEREST, AND REMOVAL AND RESTORATION COSTS
AS ADJUSTED - FOR YEAR 1978
($ millions)

	Total 1978	Sohio	ARCO	Exxon	BP	Mobil Alaska	Union Alaska	Phillips	Amerada Hess
Operating Expenses	$ 408.2	134.4	90.3	80.0	64.7	19.7	6.5	6.3	6.3
Depreciation & Amortization[1]	337.5	112.5	70.9	67.5	53.5	16.9	5.6	5.6	5.1
Removal & Restoration[2]	38.1	12.7	8.0	7.6	6.0	1.9	0.6	0.6	0.6
Return on Valuation[3]	974.7	325.0	204.7	194.9	154.4	48.7	16.2	16.2	14.6
Reported Interest	695.1	255.6	140.2	116.4	118.9	32.7	9.6	10.3	11.4
Return for Equity	279.6	69.4	64.5	78.5	35.5	16.0	6.6	5.9	3.2
Imputed Income Taxes[4]	314.0	77.9	72.4	88.2	39.9	18.0	7.4	6.6	3.6
Total[5]	2,072.5	662.5	446.3	438.2	318.5	105.2	36.3	35.3	30.2

1 ($9.280 billion ÷ 27.5 years) X percent ownership
2 ($1.049 billion ÷ 27.5 years) X percent ownership
3 10% X $9.747 billion X percent ownership
4 (Line 6 ÷ 47.1%) - Line 6
5 Line 1 plus Line 2 plus Line 3 plus Line 4 plus Line 7

TRANS-ALASKA PIPELINE SYSTEM
OPERATING EXPENSES, DEPRECIATION, INTEREST, AND REMOVAL AND RESTORATION COSTS
REPORTED BY THE CARRIERS TO THE BUREAU OF ACCOUNTS
FOR YEAR 1978
($ millions)

	Total 1978	Sohio	ARCO	Exxon	BP	Mobil Alaska	Union Alaska	Phillips	Amerada Hess
Operating Expenses	$ 408.2	134.4	90.3	80.0	64.7	19.7	6.5	6.3	6.3
Depreciation[1]	364.7	126.2	77.2	73.7	52.0	18.1	5.8	6.1	5.8
Removal & Restoration[2]	61.3	14.0	13.2	16.4	7.2	8.5	0.7	0.7	0.6
Interest	695.1	255.6	140.2	116.4	118.9	32.7	9.6	10.3	11.4
Grand Total	$1,529.3	530.2	320.9	286.5	242.8	79.0	22.6	23.3	24.2

1 Based on a 25-year service life and varying assumptions on total investment.
2 Based on a one-time cost of $1.049 billion plus varying estimates for future inflation amortized over a 25-year period.

NOTE: Columns may not add due to rounding.

THREE PRIVATE STUDIES OF THE
PROJECTED FINANCIAL STATEMENT AND AVERAGE TARIFF RATE
OF THE TRANS-ALASKA PIPELINE SYSTEM
(in cents per barrel)

	Operating Expenses 1/			Depreciation & Amortization				Return and Income Taxes						Grand Total (Cols. 3+7+13)
	Operations	Property Taxes	Total	Depreciation	Amort. of Capitalized Interest	Negative Salvage Value	Total	Cost of Debt. (Int. on 174% c/b) Amount	Percent	Cost of Equity (Return on 308c/b) Amount	Percent	Income Taxes 2/	Total (Cols. 8+10+12)	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	
Mortada Study (FEA) (Nov. 1976)	52 3/	26	78	66 4/	11 5/	0	77	157	9%	72 6/	23%	66 6/	295	450
Drexel-Burnham & Co. (Apr. 1976) 7/	20	31	51	-	-	-	84 8/	149	8.5%	83	27%	94	326	460
Wainwright Securities, Inc. (Apr. 1977)	40	33	73	50 9/	12 10/	10.3 11/	72	160	9.2%	56	18%	63	279	423

See Footnotes - Page 4

1. Based on 1.2 million barrels per day or 438 million per year.

2. Since State incomes taxes are deductible for Federal income tax purposes, the 9.4% State rate and the 48% Federal rate are equivalent to a combined rate of 52.9%, or 48% + 9.4% − (48% × 9.4%).

3. The Mortada Study originally projected 27.4¢/B (p. IV-19), then added (p. IV-23), "A communication received from a North Slope owner shortly before going to print estimates the operating costs at 25¢/B higher than our estimate."

4. $7.7 billion over 26.5 years (p. IV-19).

5. $1.3 billion over 26.5 years (*id.*).

6. Computed as follows: the study recommends an average rate of $4.50. If we deduct all prior costs and interest, the balance is $1.38 for equity and income taxes. Since the study assumes an investment tax credit of 10% (p. IV-19), the effective tax rate is .476 (i.e. 90% × 52.9%) which leaves a cost of equity of 72¢ and taxes of 66¢.

7. All figures drawn from Table II-B for 1978.

8. $6.8 billion + $1.1 billion over 25 years (pp. IV-5, IV-6) = 72. Figure of 84 "arbitrarily calculated" (p. IV-6).

9. $7.7 billion over 35 years (p. 40), or $216.9 mill./yr. (Table 10).

10. $1.3 billion 25 years (p. 40), or $51 mill./yr. (Table 10).

11. $1 billion divided by 9.7 billion barrels (p. 41).

(Columns may not add due to rounding).

PREDICTION OF RESERVOIR FLUID RECOVERY
SADLEROCHIT FORMATION
PRUDHOE BAY FIELD

Prepared for

STATE OF ALASKA
JAY S. HAMMOND, GOVERNOR
DEPARTMENT OF NATURAL RESOURCES
GUY R. MARTIN, COMMISSIONER

by

H. K. van Poollen and Associates, Inc.

January 1976

Introduction

The basic objective of this study was to evaluate the relative oil recovery potential of the Sadlerochit Reservoir at Prudhoe Bay under a number of different operating conditions.

The reservoir was modeled in cross section, using a six-layered, two-dimensional, three-phase mathematical fluid-flow simulator. This work was preceded by a published volumetric study[1] and other independent, confidential

1. "In-Place Volumetric Determination of Reservoir Fluids, Sadlerochit Formation, Prudhoe Bay Field," State of Alaska, Department of Natural Resources, Division of Oil and Gas, June, 1974, H. K. van Poollen and Associates, Inc.

studies[1] based on proprietary information which were designed to develop the best basic data with which to describe initial reservoir geometry, volume, fluid and energy conditions. During December 1975, a preliminary summary of this study was issued. Since that time, five additional cases have been studied, and are reported as Run Nos. 25 through 29. Contents of the December 1975 preliminary report have been updated and corrected. It should be recognized that the preliminary report is superceded by the present report.

Boundary Conditions

General boundary conditions were established such that the following basic cases could be evaluated and compared:

1. Depletion drive with gas cap expansion and 92% gas reinjection (8% for field use) into the gas cap from the start of producing operations—no aquifer.

2. Depletion drive with gas cap expansion and 92% gas reinjection, supplemented by a moderate-sized aquifer.

3. Depletion drive with gas cap expansion, 92% gas reinjection, and a moderate-sized aquifer supplemented by water injection beginning 4.75 years after the start of production. Water injection rate was set at 125% of the maximum oil-producing rate.

4. All of the preceding cases were also considered with gas cap sales of 2 MMMSCF/D, and some cases with 3 MMMSCF/D, and 4 MMMSCF/D, beginning 2.75 years after the start of production. All gas sales rates were net after 12% removal to account for CO_2 content, and 100 MMSCF/D assumed for fuel consumption.

1. Studies prepared by H. K. van Poollen and Associates Inc., for the Department of Natural Resources, State of Alaska.

5. Ten special cases, all with aquifer, water injection and gas cap sales, where certain operating limits were changed:

   a. Five well groups were recompleted and GOR limits increased to 25,000 SCF/STB on all wells after 13 years (GOR limit otherwise was 15,000 SCF/STB and WOR limit was 3 STB/STB for all cases).

   b. Two more well groups were added near the gas-oil contact after 14.75 years to control the potential loss of oil into the gas cap.

6. Five of the above special cases had gas sales delayed until 6.75 years.

7. A range of maximum sustained oil-producing rates of 1.2 MMSTB/D, 1.6 MMSTB/D and 1.8 MMSTB/D was set for most of the preceding cases. All runs were scheduled to produce at 0.6 MMSTB/D for the first 3 months, 1.4 MMSTB/D for the next 12 months, and then at one of the above maximum rates until the start of decline.

A total of 29 cases were run and their results are summarized in Table I.

Summary

Listed in Table I are comparable numbers for each of the 29 cases run where the end-point field-producing rate reaches 100,000 STB of oil/day. (Run No. 24, with net gas sales of 4.0 MMMSCF/D after 2.75 years was terminated after 20 years because pressure became low in the gas cap. Oil rate after 20 years was 123,000 STB/D.) Figure 1 illustrates graphically the relative magnitude of oil recovery for each case listed in Table I. Detailed yearly

results of each run are listed in Tables II through XXX, with all numbers taken at year end. Figures 19 through 47 show oil, net gas and water production rate, and cumulative production for each phase versus time. Figures 48 through 76 show oil rate, water injection, GOR, WOR and oil zone pressure versus percent oil recovery. Basic conditions and results of each run are further described in Appendix A.

A summary analysis follows:

1. Oil recoveries at an end-point field-producing rate of 100 MSTB/D range from a low 6.05 MMMSTB to a high of 8.18 MMMSTB. These recoveries are equivalent to 31.6% and 42.8% of original stock tank oil in place (Run Nos. 24 and 10).

2. The highest oil recoveries were obtained under conditions of an aquifer supplemented by water injection and no gas sales (92% reinjected with the balance for field use). Recoveries ranged from 7.70 MMMSTB (at a maximum sustained oil rate of 1.8 MMSTB/D) to 8.18 MMMSTB (at a maximum sustained oil rate of 1.2 MMSTB/D). These recoveries were obtained after 17.25 years to 25.0 years (Run Nos. 10, 11 and 12).

3. These higher ranges of oil recoveries can be approached under conditions of 2.0 MMMSCF/D gas sales and water injection if certain operating limits are changed (as in Boundary Conditions, point 5). This is true at the higher oil-producing rates of 1.6 MMSTB/D, and 1.8 MMSTB/D, where recoveries were 7.84 MMMSTB and 7.80 MMMSTB after 27.5 years and 26.25 years, respectively (Run Nos. 21 and 22).

4. Increasing gas sales above 2 MMMSCF/D for a given maximum sustained oil rate (1.6 MMSTB/D) resulted in successively reduced oil recoveries. This is true for all cases compared, as shown in Fig. 2.

5. Delaying gas sales from 2.75 years to 6.75 years had very little effect on oil recovery in the higher oil rate cases (1.6 MMSTB/D and 1.8 MMSTB/D), when the gas sales rate was 2.0 MMMSCF/D (Run Nos. 21, 22, 26 and 27). In the case of lower oil rates or higher gas sales rates, however, delay of gas sales resulted in improved oil recoveries.

   a. With gas sales of 2.0 MMMSCF/D and maximum oil rate of 1.2 MMSTB/D, oil recovery was increased from 7.35 MMMSTB to 7.85 MMMSTB, or by 6.8% (Run Nos. 20 and 25).

   b. With gas sales of 3.0 MMMSCF/D and maximum oil rate of 1.6 MMSTB/D, oil recovery was increased from 7.02 MMMSTB to 7.45 MMMSTB, or by 6.1% (Run Nos. 23 and 28).

   c. With gas sales of 4.0 MMMSCF/D and maximum oil rate of 1.6 MMSTB/D, oil recovery was increased from 6.05 MMMSTB to 7.06 MMMSTB, or by 16.0% (Run Nos. 24 and 29).

6. The lowest recoveries resulted under a combination of depletion gas cap expansion drive (no aquifer or water injection) and partial gas sales. Recoveries in this category ranged from 6.10 MMMSTB to 6.44 MMMSTB, produced within 18.25 to 19.75 years (Run Nos. 4, 5 and 6).

7. Recovery is essentially independent of oil-producing rate (within the range of 1.2 MMSTB/D to 1.8 MMSTB/D) under conditions of no gas sales and no water injection, either with or without an aquifer (Run Nos. 1, 2, 3, 7, 8 and 9).

8. Gas recoveries ranged up to 30.182 MMMMSCF or 72.33% of original total gas in place. This was for the highest gas sales rate case of 4.0 MMMSCF/D after 2.75 years (Run No. 24).

Qualifications

The numbers in this report should be considered relative rather than absolute. Reservoir performance predictions on a field without production history are approximate at best. Absolute values should be used with caution, but relative values can be used to compare production schedules with confidence.

The final recoveries of both oil and gas are influenced by the operational conditions assumed and the data imput to the model. The model data was based on volumetric studies,[1] independent aquifer response,[2] gas coning,[2] gravity drainage studies,[2] and residual oil saturations from cores. Separate sensitivity studies[2] show that aquifer response will probably be moderate to non-existent. Early production and pressure history should be monitored carefully to determine the effectiveness of a water drive.

Coning studies[2] have shown that early gas breakthrough could occur. However, the extent of impermeable barriers, production rate, and distance of perforations from the gas-oil contact greatly affects this behavior.

The results of the present study are designed to show the overall effect of fluid withdrawals on gross reservoir behavior. Detailed results based on the available data would be presumptuous in the absence of some production history.

1. Ibid, p. 1.
2. Ibid, p. 1.

Recovery of liquids from the gas cap was not considered in the model predictions. While the inclusion of gas cap liquids would provide a relative improvement to total liquid recoveries in the gas sales cases, this improvement would not be of sufficient magnitude to change the basic conclusions stated earlier. It should be recognized also that substantial gas and associated liquid recovery can be expected for the no-gas sales cases when the gas cap is finally blown down.

The prediction runs made in this study generally indicate slightly higher oil recoveries for the no-gas sales cases compared to the gas sales cases. For example, the maximum recovery for no-gas sales compared to gas sales in 2.75 years after start of production shows a difference of 0.350 MMMSTB or 4.3% (Run Nos. 10 and 21). However, it should be recognized that there are several important factors that work to reduce the net effect of this increased oil recovery which have not been determined in this study:

1. Actual gas required to fuel the turbine-driven compressors over the operating life of the field. High volumes will need to be recycled in the absence of partial gas sales.

2. The cost of additional compression equipment for reinjection over that required for gas sales compression.

3. Additional operating costs of the compression equipment over the field life.

Recommendations

1. The results of this study indicate that with or without gas sales, water injection will be beneficial for increased oil recovery. Operators should be prepared to inject water within a very few years following startup of the Field.

2. In this study only peripheral water injection was considered. Detailed study should be made of pattern injection considering permeability variations.

3. Although the prediction runs made in this study indicate that early gas sales will generally result in reduced oil recoveries, it should be recognized that important economic factors were not included in any of the boundary conditions. Further study should be made to determine the overall impact of such factors as net liquid values from gas cap processing, and power requirements to recycle the high gas volumes in the absence of gas sales.

Reservoir Model

The reservoir model used for this study was a two-dimensional, cross-sectional, three-phase mathematical fluid-flow simulator. The cross section took into account the approximate pie-cut shape of the reservoir. The model used six layers, with each layer representing one-half of the Upper, Middle and Lower zone identified in Reference 1. Each layer was divided into twenty or twenty-one concentric cells, approximately one mile wide with the length dependent on the representative contour line. Figure 3 shows a perspective view of the cross section described, including the grid numbering system used.

In addition, a 12-layer model unit with 40 concentric cells was used. That model resulted in similar answers.

Input Data

Basic input to the model was derived from independent confidential studies of data furnished by the Operators and by the State of Alaska. These data are proprietary.

Each node in the cross-sectional grid was described with values for elevation, thickness, grid dimensions, poros-

ity, permeability, initial pressure, rock compressibility, initial saturation (each phase), relative permeability (each phase), oil-water capillary pressure, gas PVT factors, oil PVT factors and water PVT factors.

Data assigned to individual producing wells included productivity index, completion interval and initial producing rate schedule.

Volumetrics

Original oil in place was 19.1 MMMSTB, with solution gas of 13.9 MMMMSCF. Gas cap volume was set at 26.5 MMMMSCF instead of the 21.2 MMMMSCF quoted in Reference 1. The reason for this increase was because of additional well control in the gas cap, and the strong possibility that gas in the Shublik is in communication with the Sadlerochit.

Rock Properties

The basic approach used to establish rock property correlations was to analyze all core and log data available, identify maximum and minimum limits and select the best average relationships.

Relative Permeability

Relative permeability relationships were developed through a normalization and curve fitting procedure.

Relative permeability to oil curves were described for two major regions, (1) near the gas-oil contact, and (2) near the water-oil contact (Figs. 4 and 5). Single gas and water relative permeability curves were applied throughout the model (Figs. 6 and 7).

Average connate water saturation used was 19.0%, based primarily on log interpretation.

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Residual oil saturations used were 23.0% in the presence of only water, and 32.0% in the presence of connate water and gas. These values were based on core analyses.

Critical gas saturation was estimated to be 3.0%.

It should be emphasized that these endpoint saturations are greatly influential in final oil recovery values obtained under any operating conditions.

Capillary Pressure

Capillary pressure data were analyzed from core data and derived from log analyses. The oil-water curve used in this model was that derived from log analyses (Fig. 8).

Absolute Permeability

Horizontal permeability used was basically 200 md, as determined from core analyses and numerous flow tests. Vertical permeability was 20 md. In layers 2, 3 and 4, horizontal permeabilities were increased by factors of 3 or 5. These values were based on evaluation of core analyses, overall shale break studies and well tests.

Rock Compressibility

Average formation compressibility was calculated from porosity compaction tests. The value used was 3.4×10^{-6} psi^{-1}.

Temperature

In this study, reservoir temperature at a given depth is assumed to be constant areally. Temperature dependent data were corrected to depth in accord with the gradient curve shown in Fig. 9 (Reference 1).

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Pressure

All available bottom-hole pressure data were analyzed and a pressure gradient curve developed as shown in Fig. 10. This relationship assumes a pressure gradient of 0.31 psi/foot in the initial oil column and is valid between the gas-oil and water-oil contact (Reference 1).

Oil PVT Data

The basic procedure used to develop oil PVT relationships was to critically analyze all fluid sample data available, compare reported fluid property results with published data and develop temperature- and pressure-corrected correlations relating fluid property behavior to depth.

Formation volume factor, solution gas-oil ratio and viscosity values as a function of pressure were developed for six depth intervals between the gas-oil contact and water-oil contact. These are shown as Figs. 11 through 16.

Gas PVT Data

A similar procedure was used to analyze all gas sample data and develop gas property relationships required.

Gas formation volume factors were calculated from reservoir pressure, reservoir temperature and applicable supercompressibility factors.

Gas composition in the gas zone was assumed to remain constant throughout the isothermal pressure reduction process.

Gas viscosity data were found to be in good agreement with published empirical correlations based on gas gravity and reservoir temperature. These correlations were, therefore, used to determine gas viscosity values. Gas PVT data used in the model are shown in Fig. 17.

Water PVT Data

Water properties were based on published correlations, based on the following parameters:

Salinity	19,125 ppm
Pressure Range	0—5,000 psig
Temperature	210° F

Water viscosity was assumed constant at 0.32 cp. Formation volume factor versus pressure is shown in Fig. 18.

Operating Conditions

It was assumed that sufficient wells would be available to maintain desired rates. A well completion in a given layer in the oil zone represents a group of wells uniformly draining the reservoir within that contour interval. Initial completion was in 80% of a layer, with two recompletions automatically made prior to shutin when GOR and WOR limits were exceeded. Withdrawals were based on volumetrics to assure uniform drainage of the reservoir. Withdrawal rates were made generally proportional to the oil volume for each cell.

Normally the gas-oil ratio was not allowed to exceed 15,000 SCF/STB, except in special cases where the limit was relaxed to 25,000 SCF/STB after 13 years. This was done for prediction Run Nos. 20 through 29. Another change made in this same group of runs was to drill 2 new well groups near the gas-oil contact after 14.75 years to prevent oil loss into the gas cap. These locations were based on high oil saturation values remaining at these nodes.

Water-oil ratio was limited to 3 for all cases throughout the study. Aquifer response was judged to be moderate to

non-existent, based on results of a previous coarse-grid, two-dimensional model study.[2]

Water injection was started after 4.75 years and maintained throughout the field life in Run Nos. 10, 11, 12 and 16 through 29. Injection rates were at 125% of the maximum sustained oil-producing rate and held constant thereafter. The injection location was placed near the water-oil contact.

Produced gas was reinjected into the gas cap from the start of producing operations for all cases. Injection volumes in the no-gas sales cases were assumed to be 92% of produced gas, with the remaining 8% assigned to field use. In those cases with gas sales, the injection volume was that remaining after subtracting 100 MMSCF/D for field use, and 12% for CO_2 removal.

2. Ibid, p. 1.

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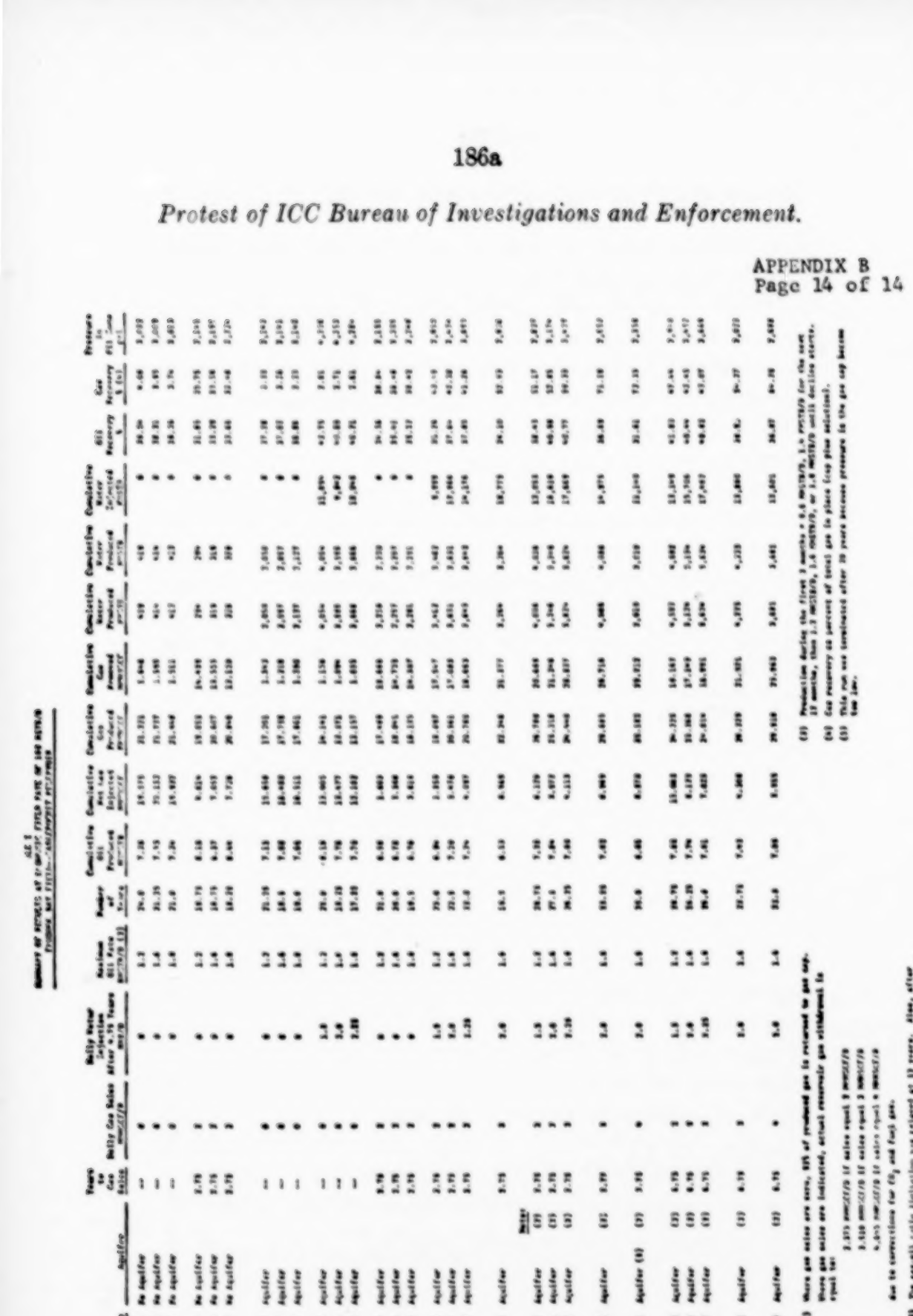
APPENDIX B
Page 14 of 14



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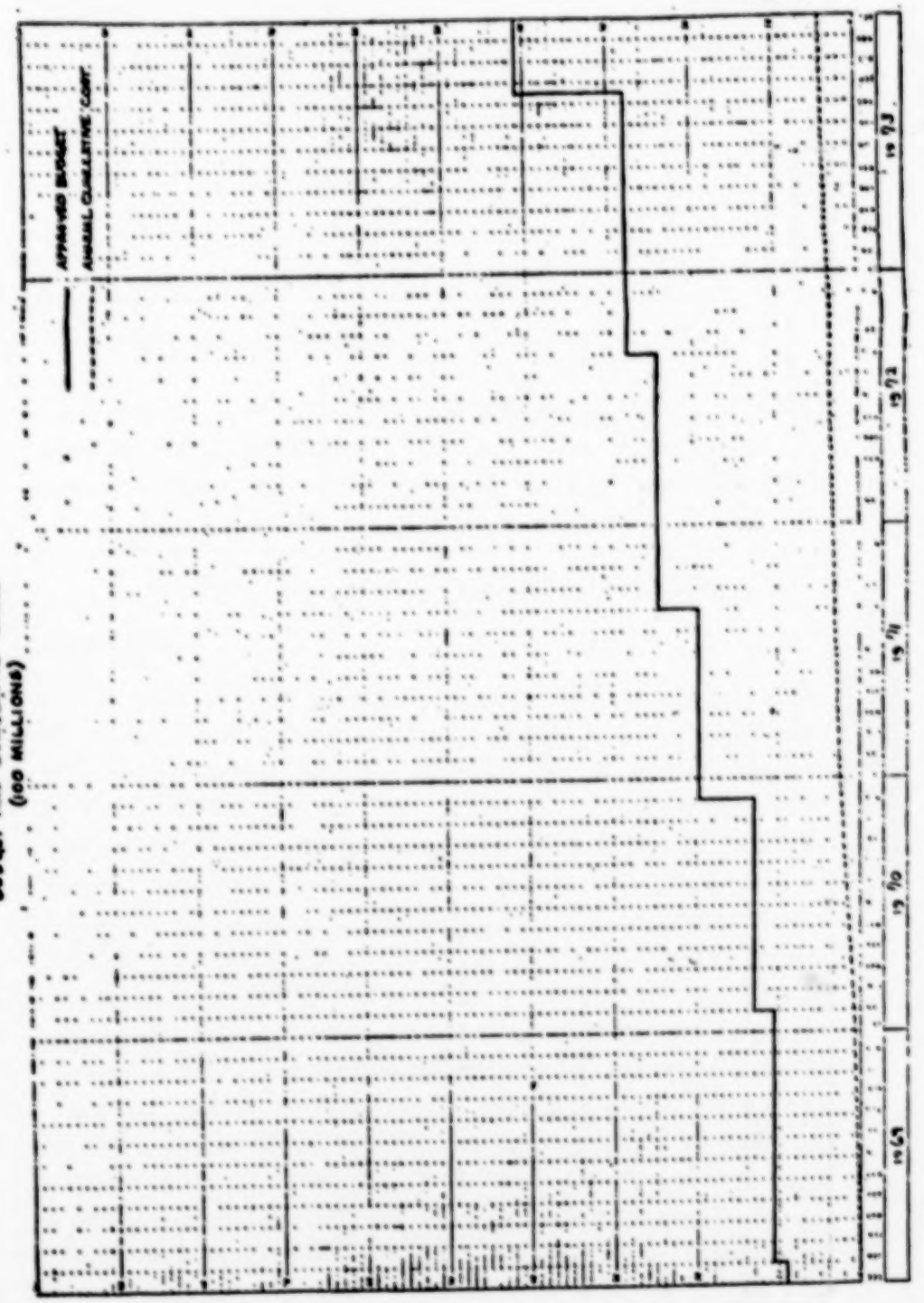
APPENDIX C
Page 1 of 2



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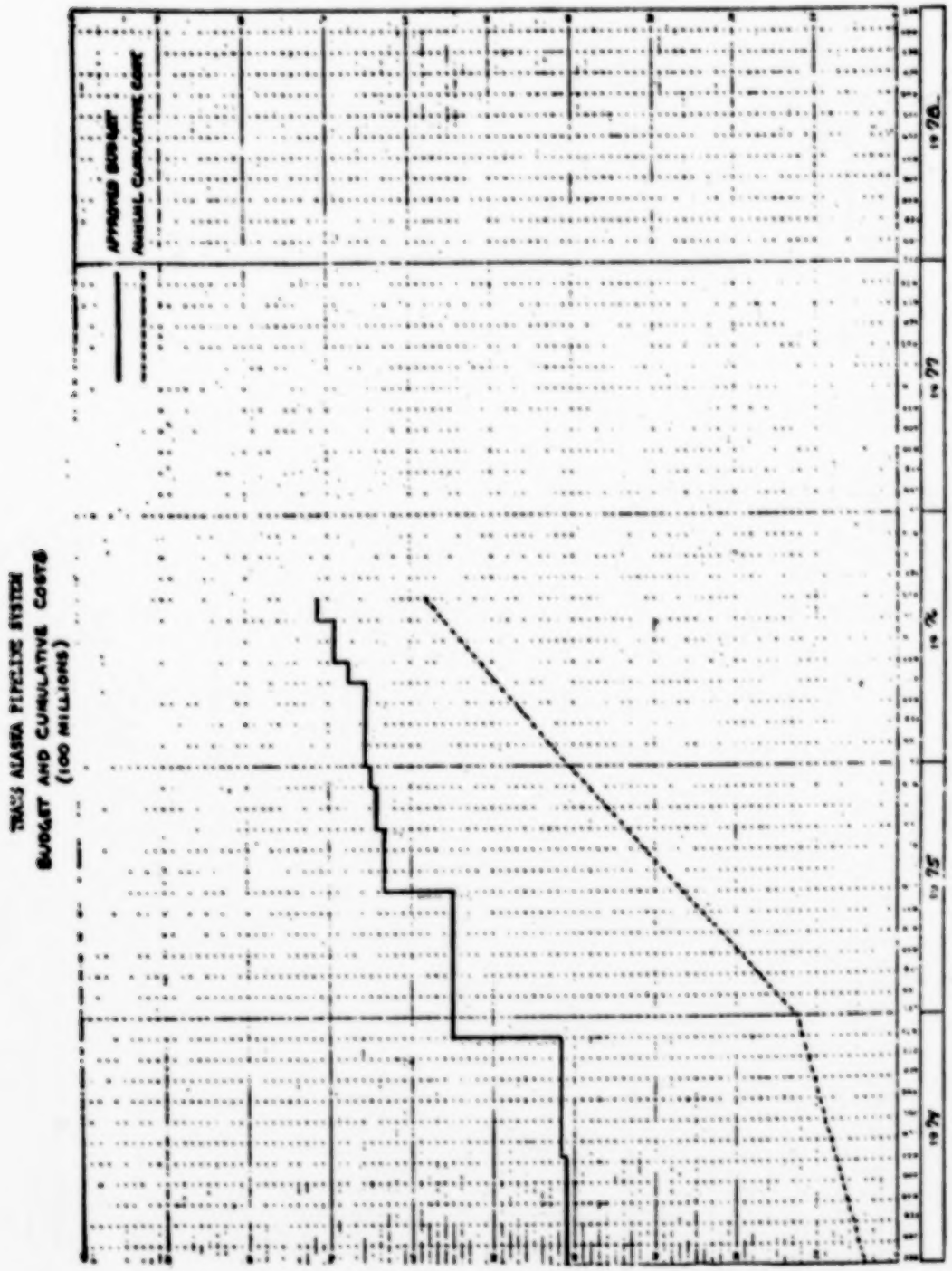
APPENDIX C
Page 2 of 2



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APPENDIX E

THE DETERMINATION OF EQUITABLE PRICING LEVELS FOR NORTH SLOPE ALASKAN CRUDE OIL

NOVEMBER 1976

Prepared for Office of Regulatory Programs

FEDERAL ENERGY ADMINISTRATION

under Contract No. CR-06-60824-00

This report was prepared under contract to the Federal Energy Administration (FEA) and does not necesssarily state or reflect the views, opinions, or policies of the FEA or the Federal Government.

TRANS ALASKA PIPELINE SYSTEM

Basic Facts

The trans-Alaska pipeline is just over 801 miles in length, of which about 375 miles will be buried and the remainder will be elevated. Current plans call for an initial capacity of 600 MB/D when the line is first completed in mid-1977, increasing to an ultimate capacity of 2 MMB/D in three stages. In the first stage, line capacity will be boosted to 1.2 MMB/D by late '77 or early '78. The capacity will be further boosted to 1.5 MMB/D in '79. Boosting the capacity further to 2 MMB/D must be coordinated with the development of speculative reserves (see Field Development Plans). Some estimates indicate that the pipeline via "looping", which employs added pipe and pump stations at various points along the line where the grade requires it, could handle 2.5 MMB/D. The Valdez terminal will have a ship-loading capacity of 80 to 110 MB/H, and can accommodate tankers of 195 MDWT. For a line capacity of

1.2 MMB/D, the storage capacity will be met through 18 tanks with 510 MB capacity each. Four berths will be required for the 1.2 MMB/D throughput, with a fifth berth to be added upon the increase in line capacity.

TRANS ALASKA PIPELINE OWNERSHIP

Company	% of line owned
SOHIO Pipe Line Company	33.34
BP Pipelines, Inc.	15.84
ARCO Pipeline Company	21.00
Exxon Pipeline Company	20.00
Mobil Alaska Pipeline Company	5.00
Union Alaska Pipeline Company	1.66
Phillips Petroleum Company	1.66
Amerada Hess Corporation	1.50

TAPS AGREEMENT

Duration of initial team: 30 years

Form of ownership: undivided joint interest

Transfer of ownership:

—permissible for cash

—partners have first purchase rights

Expansion from 1.2 MMB/D to 2.0 MMB/D

—any participant may propose

—other participants may acquire proportionate share or decline

—each partner has option to acquire share for 2 years after expansion

Construction Costs

The estimated costs of pipeline construction for 1.2 MMB/D design capacity is 7.7 billion dollars. This estimate includes the construction costs for the Valdez terminal, the fuel line, pump stations, and pumping plants. The estimated construction costs by year of expenditure and by cost item are shown in Tables IV-1 and IV-2.

Table IV-1

ESTIMATED CONSTRUCTION COSTS OF TRANS ALASKA PIPELINE SYSTEM BY YEAR OF EXPENDITURE (For 1.2 MMB/D Design Capacity)

Year	Expenditures MM$
1969	35
1970	180
1971	109
1972	49
1973	47
1974	857
1975	2,772
1976	2,698
1977	765
1978	188
Total	7,700

Protest of ICC Bureau of Investigations and Enforcement.

TRANS ALASKA PIPELINE SYSTEM
CONSTRUCTION COSTS
(MM$)

	Estimated Costs for 1.2 MMB/D (Design Capacity)
1. Alyeska Corporate	940.0
2. Bechtel—General	127.0
3. Pipeline—General	696.1
4. Pipeline Sections	1,353.6
5. Fuel Line	26.1
6. Mainline Pipe & other Permanent Materials	753.1
7. Pipeline & Roads—General	1,696.3
8. Roads—General	20.2
9. Roads	114.0
10. Yukon River Crossing	20.6
11. Fluor	171.2
12. Stations and Terminal—General	.1
13. Stations—General	14.8
14. Pump Stations	618.3
15. Topping Plants	21.1
16. Gate Valves	30.1
17. Mainline Refrigeration	5.0
18. Terminal—General	354.4
19. Terminal	738.0
Total Estimated Construction Costs	$7,700.0

Protest of ICC Bureau of Investigations and Enforcement.

DEFINITIONS OF COST ITEMS
in Table IV-2

1. Alyeska Corporate

Salaries, benefits, travel, and office operations of the Alyeska corporate staff. All Project taxes, consulting fees, engineering contracts, Federal and State inspection, ecology and earth restoration, and security services.

2. Bechtel—General

Salaries, benefits, travel, office operations, and fee of the Construction Management contractor at all locations.

3. Pipeline—General

Pipeline construction that will be distributed later to individual sections. Examples: double jointing, pipe coating and cleaning.

4. Pipeline Sections

Execution contractors' salaries, equipment, and fees. Expendable materials and equipment consumed.

5. Fuel Line

Execution contractor salaries, material, and fee to construct fuel supply line for Pump Stations 1 through 4.

6. Mainline Pipe, Valves, Fittings

48" pipe, mainline block valves and various large fittings, including freight.

Protest of ICC Bureau of Investigations and Enforcement.

7. Pipeline & Roads—General

All construction equipment furnished to the contractors, cargo and personnel transportation to the camps, hauling of 48" pipe, barge and tug operations, warehousing, and all activities related to the camps, including construction, operations, maintenance and catering.

8. Roads—General

General construction activities of the Yukon to Prudhoe haul road that will be distributed later to the road segments.

9. Roads

Haul road execution contractors' labor, material, catering, fee, and equipment. Includes the Yukon to Prudhoe, Livengood, and Dayville roads.

10. Yukon River Crossing

South road approach to the Yukon bridge, and Alyeska's share of the bridge construction.

11. Fluor

Salaries, benefits, travel, office operations, and fee of the Construction Management contractor at all locations.

12. Stations and Terminal—General

Preliminary engineering, soil testing, and progress payments to suppliers for both the terminal and the pump stations that will be distributed later.

Protest of ICC Bureau of Investigations and Enforcement.

13. Stations—General

Bulk material purchases of concrete, electrical material, piping, etc. Will be distributed later.

14. Pump Stations

Salaries for site preparation, temporary and permanent buildings, machinery and equipment. Includes pipe valves, fittings, electrical material, lighting, and instrumentation.

15. Topping Plants

Permanent buildings, distillation units, piping, electrical, insulation, machinery and equipment, excavation and civil work, structural steel. Salaries, freight, and field materials and supplies.

16. Gate Valves

Foundation and permanent buildings for control valve units, power generation buildings, equipment, and fuel storage tanks. Salaries, freight, and field material and supplies.

17. Mainline Refrigeration

Refrigeration units, compressors, sump tanks, and excavation and civil work. Salaries, freight, and field material and supplies.

18. Terminal—General

Temporary construction facilities, catering and living quarters, construction equipment, and bulk materials. Will be distributed later.

Protest of ICC Bureau of Investigations and Enforcement.

19. Terminal

Field salaries and materials for construction of the ballast water treatment, power generation, vapor recovery, tankage, and dock facilities.

20. Communications

Construction communication system and permanent Backbone communication systems for operating pipeline. Remote valve radio towers and leased circuit costs.

Protest of ICC Bureau of Investigations and Enforcement.

IV-a

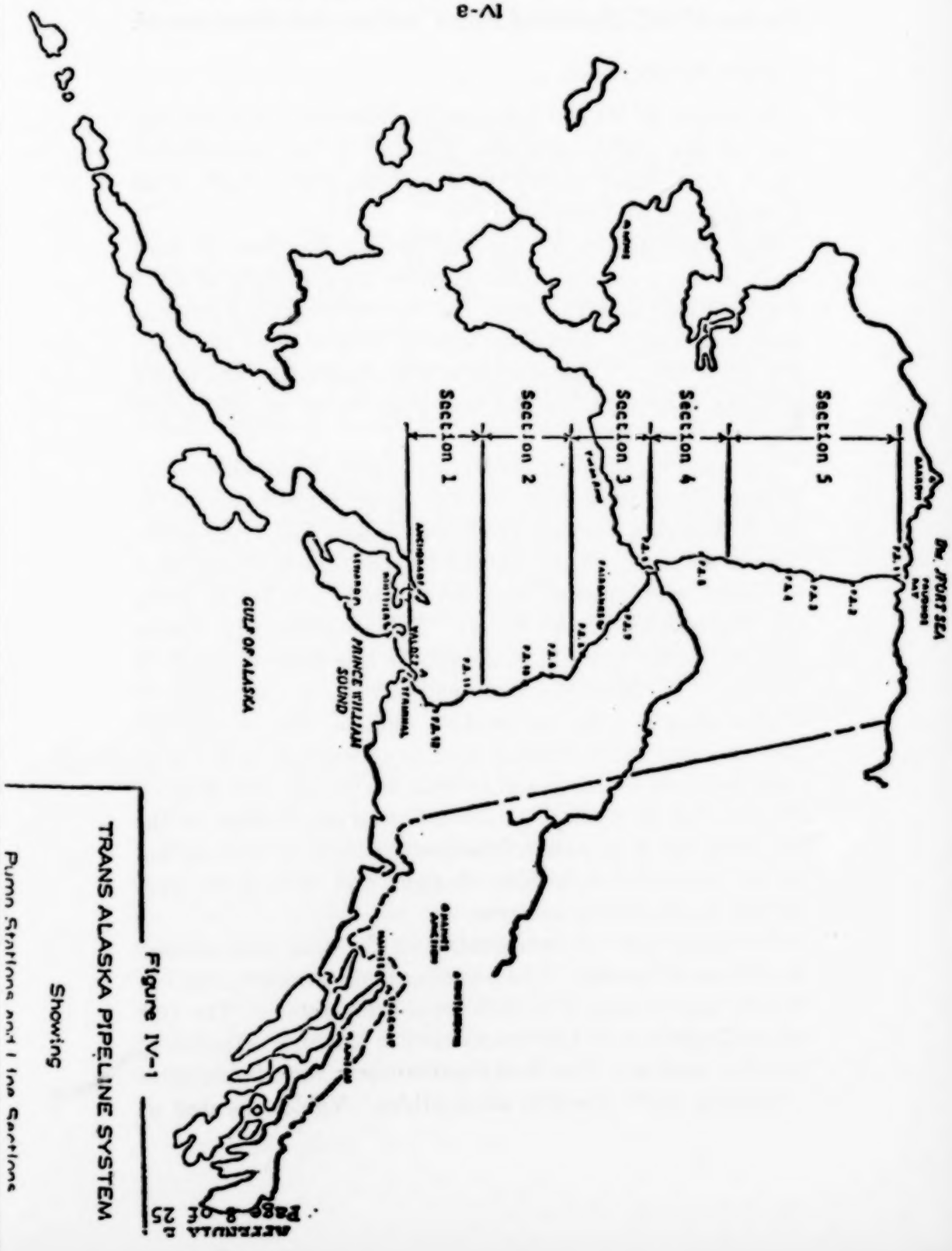

Figure IV-1

TRANS ALASKA PIPELINE SYSTEM

Showing

Pump Stations and Line Sections

System Description

A review of TAPS' construction history and a description of the major activities involved in the construction effort will further clarify the definitions and content of the 19 cost items of Table IV-2.

The trans-Alaska oil pipeline project has been in existence nearly a decade. Shortly after the discovery of oil at Prudhoe Bay in 1968, plans for the 800-mile long pipeline were announced. However, legal battles delayed construction until 1974. Construction of the pipeline system began officially with work on the haul road north of the Yukon River in April 1974.

The complex pipeline project encountered numerous challenges. It crosses some of the most rugged terrain in North America, varying from flood plains and river crossings to mountain passes. Prior to construction of the pipeline haul road, most of the area north of the Yukon River was inaccessible except by air. Soil conditions in Alaska have presented unusual challenges in line design. Much of the route is underlain with permafrost, or permanently frozen ground. In the coldest regions, the permafrost reaches close to the surface and is covered by a thin seasonal freeze-thaw layer and surface vegetation—the tundra. This serves as insulation to limit permafrost thaw in the summer, but it is easily damaged when it is in a melted state. Special construction designs and techniques were needed to protect these areas.

The possibility of earthquakes in the area was another design consideration. The pipeline, pump stations, and terminals were designed to withstand these forces. The risk of earthquakes was also considered in the final selection of pipeline location. The final pipeline route was chosen after evaluating eight possible alternatives. Valdez, located on

Prince William Sound, was chosen as the site for the southern terminus because it offered both an excellent port and because it would require the shortest pipeline. Port Valdez, both deep and wide, is protected from the open ocean and is ice-free the year round. It has plenty of space for tank farm erection and elevation of the tank farm will permit loading of ships by gravity flow.

From Prudhoe Bay south, the pipeline covers nearly 200 miles of marshy tundra until it reaches the Brooks Mountain Range. The line crosses over Dietrich Pass, approximately 4,800 ft. high, then continues down across the Interior. There it travels through 300 miles of permafrost, forest and glacial rivers. In the middle of those 300 miles, the line crosses the Yukon River at a point ½ mile wide. The pipe is mounted alongside the two-lane Yukon River bridge, the first permanent structure over the river. After crossing the Alaska Mountain Range, the pipeline continues on through Thompson Pass in the Chugach Mountains. This pass provided some of the most difficult areas of construction. The pipeline reaches Valdez 38 miles southwest of Thompson Pass.

Haul and Access Roads

The 360-mile long haul road, stretching north from the Yukon River to Surfcote at Prudhoe Bay, was completed in September 1974. This was the first major undertaking of the pipeline project and was necessary before any of the pipe could be laid. It made possible the first overland, all-weather route from the Yukon to Prudhoe. The 28-foot wide gravel road is being used during construction of the pipeline to transport workers, construction material, equipment and supplies to locations north of the Yukon.

A total of 28 million cu. yds. of gravel was used in the initial overlay, with an additional four million cu. yds. used to bring the road up to final grade conforming to State of Alaska secondary road requirements. An average of 110,000 cu. yds. of gravel was moved a day, making it possible to complete the road in five months. The 360-mile haul road cost 200 MM$.

In addition to the haul road, access roads are important in the transportation system. Fifteen permanent access roads link the main road with pump station sites and permanent airfields. All access roads to pump stations have a minimum 3-ft. gravel base on a two-lane roadway 28-ft. wide.

Airfields play a major part in the project's transportation scheme. Three permanent airfields were constructed, located near Prospect Creek Camp, Dietrich Camp, and Galbraith Camp. In addition, 8 temporary airfields were constructed.

Pipeline Construction Camps

31 construction camps are spaced along the pipeline route to house the work force involved in the construction process. The camps can be divided into three basic types: compact pump station camps housing about 250 workers; mainline construction camps, ranging in capacity from 300 to 1600 persons; and the Valdez Terminal Camp housing about 3,500 workers. The camps are of standardized modular construction, joined by covered walkways. A typical pipeline camp cost nearly 10MM$ to build; pump station camps cost from 6 to 7 MM$.

Pipeline Construction Modes

The pipe being used on the project was supplied by Japanese mills. It is 48″ in diameter with wall thicknesses

of .462″ and .562″. Different grades of pipe are used depending on the pressure and stress in each section.

Oil will leave the separation facilities at a maximum of 140°F. Due to heat generated by pumping and friction within the pipe, the oil will lose only some of that heat as it travels through the line. Because of the effect of heat on certain terrain and soil along the route, three construction modes have been developed for the various ground conditions. These modes are conventional burial, above ground, and special burial.

In conventional burial, the pipe is placed underground at depths ranging from three to twelve feet. This type of burial is being used on about 375 miles of line, in areas with stable soil, gravel or bedrock, or in areas where field exploration and analysis have shown that soil settlement or instability resulting from thawing would not damage the terrain or the pipeline.

The above ground mode or pipe installation is being used in areas where heat from the buried pipe would damage unstable permafrost. Installed on 423 miles of the pipeline, the above ground pipe is mounted on cross beams on vertical support members (VSMs)—18-inch pipes, spaced approximately 50 to 70 feet apart. The mounted pipe is fully insulated with four inches of resin-impregnated fiber glass covered with a galvanized steel jacket. The support assemblies and valves are covered with molded fiber glass and polyurethane foam. This insulation will prevent oil and pipe from chilling below the pour point during an extended shutdown.

Almost 80,000 VSMs are being used in construction of the line. Each one is placed in a pre-bored 24-inch hole and surrounded by a specified mixture of sand and water which expands when it is frozen, binding the pipes to the sur-

rounding ground. Approximately 70% of all the VSMs will have self-supporting heat pipes installed inside to keep the soil around the supports frozen. The heat pipes consist of sealed sections of pipe, containing anhydrous ammonia and topped by a finned radiator. The heat pipes are designed to operate when the temperature of the air is colder than the ground temperature. The ammonia absorbs heat from the soil, vaporizes, and rises; the heat is discharged into the air through the radiator. The ammonia vapor then condenses and returns to the bottom of the pipe where the cycle is repeated. The heat pipes will operate only in cold weather. In this way, the frozen condition of the permafrost will be maintained year round.

Above ground, the pipeline follows a zigzag configuration. This is because steel pipe expands when heated, and if the ends of the pipe are locked in place, the expansion forces set up stresses that bend the pipe. The zigzag pattern allows for expansion without stress by converting the tendency for lengthwise expansion to a sideways movement.

At several locations, special burial techniques for the pipeline were used. One technique utilizes 6-inch chilled coolant circulation pipes laid in the ditch bedding alongside the insulated pipe. The coolant pipes reduce heat transfer and provide heat removal to maintain the permafrost in a frozen state.

The pipeline route crosses more than 800 streams and rivers between Prudhoe Bay and Valdez. The two-lane Yukon River bridge was built to highway standards by the State of Alaska. The bridge, 2,300 ft. in length, is supported by five river piers. There are two suspension bridges at the Tanana and Tazlina Rivers, with free-spans of 1,200 ft. and 650 ft., respectively. All bridge designs provide for expansion due to thermal effects.

Pump Stations

For the initial throughput rate of .6 MMB/D, five pump stations will be required with one pump in each station. When the line capacity reaches 1.2 MMB/D, two pumps will be used in each of 8 stations. By the time the line reaches its capacity of 2 MMB/D, four additional stations will be required for a total of 12 stations with 3 pumps in each station. The pumps are multi-stage centrifugal pumps, driven by 13,500-hp. jet engine/power turbine drivers. Since the pipeline crosses three mountain ranges, the pump stations are spaced close together on the up-slopes and widely spaced on down-slopes. Natural gas from the Prudhoe Bay oil fields will be the fuel for pumps and power at Stations 1, 2, 3 and 4 north of the Brooks Range. 25 MMCF/D of gas will be required to fuel these stations for a throughput capacity of 1.2 MMB/D. Small refineries or topping units at Pump Stations 6, 8 and 10 will supply fuel for the remaining stations.

Communication Network and Control System

A communication network will link the stations with each other and with the Valdez Control Center via radio, microwave and earth satellite. The pipeline will be regulated by the Control Center at the terminal at Valdez. The control network will include a master station with computers at Valdez and 12 remote stations—one located at each of the pump stations. Data for over 100 variables describing operating conditions will be telemetered to the control center. Such items as condition of the valves, whether open or closed, power consumption and security information will be telemetered. The central computer will give a total update on every station at least every 10 seconds.

Valdez Terminal

The terminal facilities include tank farms, docks, tanker loading, ballast water treatment, power plant, vapor recovery system, and the pipeline control center. For the 1.2 MMB/D design capacity, 18 storage tanks will be required with 510 MMB capacity each. By the time the pipeline reaches its design capacity of 2 MMB/D, 32 storage tanks will be required.

A ballast treatment facility will receive the sea water ballast carried by the tankers in order to stabilize the vessels while they are without a cargo of oil. The ballast will remain in steel tanks for a minimum of six hours during which the oil will rise to the surface and be skimmed and pumped to the oil recovery section of the treatment plant and then back to the terminal's crude storage tanks. Five berths will be required when the throughput reaches 2 MMB/D. The berths are designed to handle tankers of 195 MDWT. The loading rate will be between 80 and 110 MB/H. Turn-around time, including docking, ballast discharge, loading oil, undocking, documentation and other port-related activities will take 36 hours.

Tariff Computation

The Prudhoe Bay Field development plans presented in this report identify three possible alternatives. Each alternative results in a different rate of production and throughput for the pipeline. Consequently, the computed tariff rates are different for each development plan. The tariffs were computed for each case for the years 1977-1994 according to the ICC and Justice Department guidelines as outlined in the Assumptions. After 1994, and due to the rapid decline in the field production rate, the computed

tariff would have to be increased sharply to yield to the owners 7% on the valuation of the pipeline. It was therefore assumed that by 1994, either new fields would have been discovered or the owners would accept less than the 7% allowed by the ICC. From 1995 on, the tariff was increased at 10¢/B annually. This assumption has little effect on the recommended crude price, since the rate of return is computed on the investment in the field and pipeline. The three cases for which the tariff was computed are summarized below.

Case I: Field development in this case is limited to Prudhoe Oil Pool. The field production rate was limited to 1.5 MMB/D and held at that rate through 1985, after which it begins to decline. The pipeline capacity was expanded in 1979 from 1.2 MMB/D to 1.5 MMB/D. The cost of the expansion was estimated at 520 MM$ plus 50 MM$ for construction interest. This brings the total estimated cost of the pipeline for 1.5 MMB/D capacity to 8,220 MM$ plus 1,350 MM$ for construction interest. The tariff for *Case I in 1976 dollars varies between 3.45 and 5.40 $/B.*

Case II: Field development in this case includes a lower estimate of the reserves of the Kuparuk and Lisburne Oil Pools. The rate of throughput for the pipeline increases to 1.77 MMB/D and is held through 1985, after which it begins to decline. It was necessary, therefore, to increase the pipeline capacity to the next level of 2 MMB/D. The estimated cost for increasing the pipeline capacity from 1.5 to 2.0 MMB/D is 500 MM$ plus 50 MM$ for construction interest. The total cost of the line is estimated to be 8,720 MM$ plus 1,400 MM$ for construction interest. The increase in throughput for this case outweighs the increase in cost required to increase the line capacity. Therefore, it

results in a lower tariff than in *Case I. The tariff for Case II in 1976 dollars varies between 3.10 and 5.60 $/B.*

Case III: The field development in this case includes the upper estimate of the reserves of the Kuparuk and Lisburne Oil Pools. The rate of throughput for the pipeline increases to 1.915 MMB/D and is held through 1985, after which it begins to decline. This case requires no additional investment in TAPS over Case II. However, *because of the increased rate of throughput the tariff in 1976 dollars varies between 2.90 and 5.60 $/B.*

TRANS ALASKA PIPELINE SYSTEM

ASSUMPTIONS FOR TARIFF COMPUTATION
(All Costs in Billion Dollars)

1.	Cost of construction for 1.2 MMB/D design capacity	= 7.70
2.	Construction interest for (1) above	= 1.30
3.	Cost of expansion to 1.5 MMB/D	= .52
4.	Construction interest for (3) above	= .05
5.	Operating costs	= .274 $/B
6.	State of Alaska corporate income tax	= 9.4 %
7.	State of Alaska ad valorem tax based on economic value of pipeline	= 2 %
8.	Debt to capital ratio	= .85
9.	Interest on debt	= 9.0 %/annum
10.	Debt is retired in equal installments over a 25-year period.	
11.	For rate determination, pipeline depreciation is normalized (i.e. straight line) over 26.5 years. Federal and state income taxes allowed in rate determination are based on normalized depreciation. [Reference: ICC Docket No. 35533; William Bros. Pipeline Co., October 10, 1975].	
12.	The ICC valuation base declines at 6% per annum.	
13.	The maximum profit permitted on the ICC valuation base is 7% per annum.	
14.	For actual federal income tax, the line is depreciated using double declining balance over 17.5 years.	
15.	Federal corporate income tax	=48 %
16.	Investment tax credit	=10 %

Table IV-3

TRANS ALASKA PIPELINE SYSTEM

COMPUTED TARIFF AND PIPELINE ECONOMICS

CASE I: LINE CAPACITY 1.8 MMB/D
(Field Development Limited to Prudhoe Oil Pool)

Year	Throughput MB/D	Throughput MMB/Y	Tariff ¢/B	Gross Revenue MM$	Operating Costs MM$	State Taxes Ad Valorem MM$	State Taxes Corporate MM$	Federal Income Tax MM$	Capital Investment MM$
1969									35
70									160
71									100
72									49
73									47
74									858
75									2772
76									2600
77	600	140	540	788	40	53			765
78	1200	438	540	2365	120	115	53		180
79	1400	511	485	2476	140	108	66		520
1980	1500	548	435	2384	150	102	73	184	
81	1500	548	415	2274	150	96	73	338	
82	1500	548	395	2165	150	90	73	337	
83	1500	548	380	2082	150	84	74	344	
84	1500	548	365	2000	150	78	75	347	
85	1500	548	345	1891	150	75	73	336	
86	1430	518	345	1791	142	70	72	334	
87	1305	476	360	1717	131	66	71	329	
88	1210	442	365	1613	121	62	70	322	
89	1110	405	360	1519	111	58	70	322	
1990	1004	367	365	1455	104	55	68	314	
91	912	345	395	1375	95	51	67	309	
92	870	318	410	1304	87	48	66	304	
93	801	292	420	1231	80	45	64	299	
94	792	287	430	1148	74	43	61	284	

Pre-1976 costs expressed in actual dollars (i.e., money of the day).
Post-1976 costs and revenues expressed in 1976 dollars.

Table IV-4

TRANS ALASKA PIPELINE SYSTEM

COMPUTED TARIFF AND PIPELINE ECONOMICS

CASE II: LINE CAPACITY 2.0 MMB/D
(Field Development Includes Lower Estimate of Kuparuk and Lisburne Pools)

Year	Throughput MB/D	Throughput MMB/Y	Tariff ¢/B	Gross Revenue MM$	Operating Costs MM$	State Taxes Ad Valorem MM$	State Taxes Corporate MM$	Federal Income Tax MM$	Capital Investr MM$
1969									35
70									160
71									109
72									49
73									47
74									858
75									2772
76									2600
77	600	146	560	818	40	53			765
78	1200	438	560	2453	120	115	58		708
79	1500	548	475	2603	150	122	73		500
1980	1600	584	430	2511	160	125	74	61	
81	1720	628	385	2418	172	117	77	357	
82	1760	642	360	2315	176	110	78	350	
83	1770	646	340	2200	176	104	77	354	
84	1770	646	325	2103	177	98	76	353	
85	1770	646	310	2006	177	92	76	350	
86	1655	604	315	1903	166	86	76	349	
87	1535	560	325	1823	154	81	75	345	
88	1435	524	330	1729	144	76	74	344	
89	1325	484	340	1621	133	72	74	341	
1990	1234	450	345	1556	123	67	72	334	
91	1142	417	350	1469	114	63	70	322	
92	1040	380	365	1387	104	59	69	319	
93	956	349	375	1309	96	56	67	312	
94	872	318	385	1186	87	53	62	286	

Pre-1976 costs expressed in actual dollars (i.e., money of the day).
Post-1976 costs and revenues expressed in 1976 dollars.

Protest of ICC Bureau of Investigations and Enforcement.

Table IV-5

TRANS ALASKA PIPELINE SYSTEM

COMPUTED TARIFF AND PIPELINE ECONOMICS

CASE III: LINE CAPACITY 2.0 MMB/D

(Field Development Includes Upper Estimate of Kuparuk and Lisburne Pools)

Year	Throughput MB/D	Throughput MMB/Y	Tariff 4/B	Gross Revenue MM$	Operating Costs MM$	State Taxes Ad Valorem MM$	State Taxes Corporate MM$	Federal Income Tax MM$	Capital Investment MM$
1969									35
70									160
71									109
72									49
73									47
74									153
75									2772
76									2693
77	800	146	500	818	40	53	55	61	765
78	1200	438	500	2453	120	115	73	356	108
79	1500	548	475	2603	156	122	74	352	500
1980	1600	584	450	2511	173	125	77	353	
81	1794	655	370	2424	179	117	76	361	
82	1859	679	340	2309	186	110	76	354	
83	1850	679	325	2207	188	104	78	350	
84	1915	699	305	2135	192	98	78	341	
85	1915	699	290	2030	193	92	76	336	
86	1850	657	280	1941	180	86	74	334	
87	1677	612	300	1839	168	81	73	331	
88	1574	575	300	1725	157	76	73	322	
89	1458	532	310	1652	146	72	72	312	
1990	1357	495	315	1562	136	67	70	306	
91	1250	460	320	1472	125	63	67	305	
92	1145	418	330	1379	114	59	66		
93	1052	384	340	1306	105	56	63		
94	958	350	355	1243	98	53	60		

Pre-1976 costs expressed in actual dollars (i.e., money of the day).
Post-1976 costs and revenues expressed in 1976 dollars.

Protest of ICC Bureau of Investigations and Enforcement.

Some Comments on Tariff Computation

Gross Revenue = throughput × tariff.

Operating Costs are based on the estimated manpower required to operate and maintain the line. Alyeska and TAPS owners are still in the process of developing an operating budget for TAPS and could not confirm or infirm our estimate.

State Corporate Income Tax = .094 of taxable income from the pipeline. Discussions with Alaska Department of Revenue indicate that the State of Alaska applies allocation and apportionment in multi-state taxation. The application of multi-state taxation would require estimating total corporate income by pipeline owner from all activities and allocating it back to each activity based on certain allocation formulas. This approach could not be followed here because it would be unrealistic to estimate the future corporate income of each TAPS owner for the entire life of the project.

Tables IV-3, IV-4, and IV-5 present the computation of the tariff, gross revenue, operating costs, State of Alaska ad valorem and corporate income taxes, federal income tax and capital investment. These results were merged with the results of calculations from Prudhoe Bay and used to calculate a rate of return on the investment in the field and pipeline.

A communication received from a North Slope owner shortly before going to print estimates the operating costs at 25¢/B higher than our estimate. Since TAPS' operating costs are passed in toto to the tariff, and since this change increases the real rate of return on the investments in TAPS and the field by 6 basis points only, it was possible to

account for this change without repeating the entire computation and analysis.

Average Tariff for First 10 Years of Pipeline Operation

	$/B
Case I	4.50
Case II	4.30
Case III	4.20

Effects of Inflation on Pipeline Tariff

Inflation impacts the tariff in three ways:

— The valuation base at any given time is affected by the rate of inflation, which determines the replacement cost of the line.

— The interest charges on the debt are also affected by the rate of inflation. Portions of the debt will be refinanced at maturity at interest rates which depend on the rate of inflation.

— The future operating costs of the line will also depend on the rate of inflation and will directly impact the tariff.

Pipeline Tariffs in 1987 at 7% Inflation

	$/B
Case I	4.80
Case II	4.35
Case III	4.05

"RECOMMENDATION OF THE FEDERAL POWER COMMISSION TO THE PRESIDENT-
ALASKA NATURAL GAS TRANSPORTATION SYSTEMS - MAY 1, 1977"

APPENDIX XII-A

PROFITABILITY AND FINANCIAL STRUCTURE OF INTEGRATED PETROLEUM COMPANIES 1/

($ Millions)

COLUMN 1 Year	COLUMN 2 Net Income After Tax 2/	COLUMN 3 Net Worth 2/	COLUMN 4 After-Tax Return on Equity (%) (Col. 2÷Col. 3)	COLUMN 5 Long-Term Debt	COLUMN 6 Total Capitalization (Col. 3+Col. 5)	COLUMN 7 Long-Term Debt to Total Capital Ratio (Col. 5÷Col. 6)
1966	5,732	52,859	10.8%	8,612	61,471	14.0%
1967	6,206	56,392	11.0	10,565	66,957	15.8
1968	6,752	59,999	10.9	13,187	73,186	18.0
1969	6,760	63,570	10.6	14,864	78,434	19.0
1970	6,701	66,885	10.0	16,756	83,641	20.0
1971	7,328	70,838	10.3	19,339	90,177	21.4
1972	6,898	72,514	9.5	20,283	92,797	21.9
1973	11,766	80,100	14.2	20,813	100,913	20.6
1974	16,558	92,446	17.9	23,092	115,538	20.0
1975	11,977	96,874	12.4	30,645	127,519	24.0
Average 1966-1975	N.A.	N.A.	11.8	N.A.	N.A.	N.A.
Average 1973-1975	N.A.	N.A.	14.8	N.A.	N.A.	N.A.

1/ Data from Chase Manhattan Bank financial statistics on a group of 28 petroleum companies. Data base changed to 29 companies in 1975.

2/ Includes minority interest.

VERIFIED STATEMENT OF DAVID L. JONES OF THE COMMISSION'S BUREAU OF ECONOMICS

IN EX PARTE NO. 308, VALUATION OF COMMON CARRIER PIPELINES

Table 6

Capitalization of U.S. oil pipeline companies, 1939-1975

(Dollars in millions)

As of December 31	Number of companies	Total capitalization	Capital stock	Capital stock as percent of total capitalization	Funded debt unmatured	Funded debt unmatured as percent of total capitalization
1939	57	$ 310.0	$273.3	88.2	$ 36.7	11.8
1940	55	294.3	264.2	89.6	30.5	10.4
1941	58	292.5	254.6	87.0	37.9	13.0
1942	54	301.2	255.1	84.7	46.1	15.3
1943	57	297.1	250.0	84.1	47.1	15.9
1944	57	282.6	243.4	86.1	39.2	13.9
1945	59	301.2	253.8	84.3	47.4	15.7
1946	58	297.8	240.1	80.6	57.7	19.4
1947	58	339.3	233.8	68.9	105.5	31.1
1948	59	439.2	235.4	53.6	203.8	46.4
1949	61	548.6	235.7	43.0	312.9	57.0
1950	63	660.3	236.1	35.8	424.2	64.2
1951	64	759.3	281.5	37.1	477.8	62.9
1952	62	1,023.5	290.6	28.4	732.9	71.6
1953	68	1,177.2	319.3	27.1	857.9	72.9
1954	72	1,265.6	325.7	25.7	939.9	74.3
1955	74	1,282.0	331.1	25.8	950.9	74.2

(Continued)

APPENDIX 2
Page 1 of 2

Table 6 continued

As of December 31	Number of companies	Total capitalization	Capital stock	Capital stock as percent of total capitalization	Funded debt unmatured	Funded debt unmatured as percent of total capitalization
1956	74	$1,304.5	$339.4	26.0	$ 965.1	74.0
1957	75	1,357.3	344.6	25.4	1,012.7	74.6
1958	78	1,383.6	351.7	25.4	1,031.9	74.6
1959	79	1,385.1	359.4	25.9	1,025.7	74.1
1960	82	1,439.3	383.8	26.7	1,055.5	73.3
1961	84	1,396.8	338.0	24.2	1,058.7	75.8
1962	87	1,383.5	340.4	24.6	1,043.1	75.4
1963	89	1,685.2	378.4	22.5	1,306.8	77.5
1964	85	1,620.2	380.5	23.5	1,239.7	76.5
1965	84	1,634.5	382.0	23.4	1,252.5	76.6
1966	82	1,789.9	388.4	21.7	1,401.5	78.3
1967	85	1,943.1	405.4	20.9	1,537.1	79.1
1968	92	2,129.6	431.5	20.3	1,698.1	79.7
1969	99	2,267.1	443.6	19.6	1,823.5	80.4
1970	101	2,517.4	449.8	17.9	2,067.6	82.1
1971	99	2,964.4	448.9	15.1	2,515.5	84.9
1972	99	3,183.7	428.2	13.4	2,755.5	86.6
1973	100	3,168.4	437.1	13.8	2,731.3	86.2
1974	103	4,093.4	450.8	11.0	3,642.6	89.0
1975	105	6,041.5	431.5	7.1	5,610.0	92.9

Source: *Petroleum Facts and Figures*, 1971 Edition, American Petroleum Institute, P. 535 (1939-1968) and Interstate Commerce Commission, *Transport Statistics in the United States*, Part 6, Bureau of Accounts.

APPENDIX 2
Page 2 of 2

Interstate Commerce Commission Order Instituting Investigation of Rules Tariffs Through Trans-Alaska Pipeline, June 17, 1977.

ORDER

At a General Session of the INTERSTATE COMMERCE COMMISSION, held at its office in Washington, D.C., on the 17th day of June, 1977.

No. 36611

TRANS-ALASKA PIPELINE SYSTEM

It appearing, That there have been filed with the Interstate Commerce Commission tariff schedules setting forth new rules and regulations affecting rates and charges, applicable on interstate or foreign commerce, in connection with the transportation of crude petroleum by pipeline from Prudhoe Bay, Alaska, to become effective June 20, 1977, and later designated as follows:

AMERADA HESS PIPELINE CORPORATION,
I.C.C. No. 1;
ARCO PIPE LINE COMPANY,
I.C.C. No. 1030,
on pages 2 through 13, ITEMS 1 through 17;
BP PIPELINES, INC.,
I.C.C. 1;
EXXON PIPELINE COMPANY,
I.C.C. No. 124;
MOBIL ALASKA PIPELINE COMPANY,
I.C.C. No. 1;
SOHIO PIPE LINE COMPANY,
I.C.C. No. 742,
on pages 3 through 13, ITEMS 5 through 110;
UNION ALASKA PIPELINE COMPANY,
I.C.C. No. 1;

or as same may be amended or reissued;

It further appearing, That upon consideration of the said tariff schedules and protests thereto, there is reason to

believe that the rules, regulations and provisions contained in such schedules may result in the application of rates and charges that are unjust and unreasonable and otherwise unlawful in violation of the Interstate Commerce Act;

And it further appearing, That the rates and charges affected by these rules and regulations will be considered by the Commission at a time subsequent to the service date of this order;

Wherefore:

It is ordered, That an investigation be, and it is hereby instituted into and concerning the lawfulness of the rules, regulations and provisions contained in said schedules, with a view to making such findings and orders in the premise as the facts and circumstances shall warrant.

It is further ordered, That the investigation in this proceeding shall not be confined to the matters hereinbefore stated as the reason for instituting this investigation, but shall include all matters and issues with respect to the lawfulness of the said schedules under the Interstate Commerce Act.

And it is further ordered, That the carriers parties to the schedules named herein be, and they are hereby, made respondents to this proceeding; that copies of this order be served upon the said respondents; and that a notice of this proceeding be given to the public by posting a copy of this order in the Office of the Secretary of the Commission.

By the Commission. (Commissioners Murphy, Hardin, and Christian not participating).

H. G. Homme, Jr.
Acting Secretary

(SEAL)

Response of Sohio Pipeline Co. to June 2 Request.

[LETTERHEAD SOHIO PIPILINE COMPANY]

June 13, 1977

Interstate Commerce Commission
Constitution Avenue and 12th Street, N.W.
Washington, D. C. 20423

Gentlemen:

This responds to the Commission's "Request For Prompt Filing of Data Concerning Proposed Rate Levels" by the owners of the Trans-Alaska Pipeline System (TAPS). On June 3, 1977, Sohio Pipe Line Company filed with the Interstate Commerce Commission a tariff of $6.16 per barrel for the interstate movement of crude oil from Prudhoe Bay, Alaska, to the Valdez Terminal at Valdez, Alaska, via TAPS. This amount represents Sohio Pipe Line Company's best judgment as to a just and reasonable rate for its service at the present time and for the near term future after consideration by the Company's management of relevant factors now apparent governing this rate. We attach financial data so considered by the Company. These data will show, we believe, that the rate of earnings which Sohio Pipe Line Company estimates will be produced by its initial tariff will not exceed any lawful criterion of the reasonableness of such earnings.

Schedule I attached is a summary which reflects the estimated results of the operation of Sohio Pipe Line Company's tariff through 1982. This period of time embraces, in addition to the operations for the remainder of this year (which include, of course, costs associated with start-up), two full years of operation at the estimated initial capacity of the line, and three full years of operation at an assumed expanded capacity. The use of the five and a fraction year period does not necessarily indicate a determination by the Company either that no change in the tariff will be appropriate for such period of time or that such tariff will be changed at the end of such period. Factors that will be known only after commencement of actual operation of TAPS, such as its actual operating costs and throughput, may affect the rate level that is appropriate for Sohio Pipe Line Company's TAPS service from time to time.

We endeavored, in developing Schedule I and the data which underlie it, to reflect our understanding of the methods traditionally utilized in testing the effect and fairness of common carrier pipeline rates. Valuation was determined by what we understand to be the method normally used by the Commission in determining pipeline valuation. Depreciation is straight line and based on a 25 year life which is the estimated life of the field to be served by the pipeline. The interest expense is Sohio Pipe Line Company's actual interest expense. Income taxes are "normalized" by calculating such taxes as if the depreciation shown on the schedule were used for tax purposes. In addition, it does not reflect any reduction in taxes which may result from the use of the investment tax credit.

We include the following schedules which support or are relevant to an evaluation of Schedule I:

Schedule II: Projected TAPS Throughput Schedule
Schedule III: Debt Issues & Interest Expense
Schedule IV: Operating Expenses
Schedule V: Valuation
Schedule VI: Depreciation and Ad Valorem Tax

Sincerely,

J. T. BOLTACZ
Vice President, Sohio Pipe Line Company

JTB/LCT/skl
Attachments

SOHIO PIPE LINE COMPANY

TAPS TARIFF BASIS

	4 MONTHS 1977	1978	1979	1980	1981	1982	1983
TARIFF $/BARREL	$6.16	$6.16	$6.16	$6.16	$6.16	$6.16	$6.16
REVENUE	169.4	899.4	899.4	1161.8	1161.8	1161.8	1161.8
AD VALOREM TAXES	14.7	51.0	49.5	51.6	49.3	47.0	44.8
OPERATING EXPENSES	38.8	98.2	98.2	103.6	103.6	103.6	103.6
DEPRECIATION	41.5	126.2	126.8	136.8	136.8	136.8	136.8
INTEREST EXPENSE	84.4	252.5	250.2	261.9	248.8	235.0	209.4
TOTAL EXPENSES	179.4	527.9	524.7	553.9	538.5	522.4	494.6
STATUTORY INCOME TAXES	(5.3)	196.5	198.2	321.6	329.7	338.2	352.9
NET INCOME	(4.7)	175.0	176.5	286.3	293.6	301.2	314.3
RATE OF RETURN %	Neg.	5.3	5.4	8.3	8.7	9.1	9.7
VALUATION	3288.8	3315.0	3282.5	3444.1	3375.5	3308.3	3242.5
SHIPMENTS (MILLIONS)	27.5	146.0	146.0	188.6	188.6	188.6	188.6
NET INCOME	(4.7)	175.0	176.5	286.3	293.6	301.2	314.3
PERMISSIBLE EARNINGS @ 7%	76.7	232.1	229.8	241.1	236.3	231.6	227.0
EXCESS/(DEFICIT) EARNINGS	(76.7)	(57.1)	(53.3)	45.2	57.3	69.6	87.3
EXCESS EARNINGS ALLOCATED FOR CARRYBACK	0	0	0	45.2	57.3	53.1	0
CARRYBACK INCOME	45.2	57.1	53.3				
FROZEN EARNINGS/(LOST EARNINGS)	(31.5)	0	0	0	0	16.5	87.3
ACCUMULATIVE NET INCOME	40.5	272.6	502.4	743.5	979.8	1227.9	1542.2
ACCUMULATIVE RATE OF RETURN %	3.7	6.2	6.5	6.7	6.8	6.9	7.3

Response of Sohio to June 2 Request.

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SCHEDULE I

SOHIO PIPE LINE COMPANY

TAPS TARIFF BASIS

YEARLY SUMMARY
(MILLION OF DOLLARS)

	4 MONTHS 1977	1978	1979	1980	1981	1982
TARIFF $ PER BARREL	$6.16	$6.16	$6.16	$6.16	$6.16	$6.16
SHIPMENTS MILLIONS BARRELS PER YEAR	27.5	146.0	146.0	188.6	188.6	188.6
VALUATION	3288.8	3315.0	3282.5	3444.1	3375.5	3308.3
AD VALOREM TAXES	14.7	51.0	49.5	51.6	49.3	47.0
OPERATING EXPENSES	38.8	98.2	98.2	103.6	103.6	103.6
DEPRECIATION	41.5	126.2	126.8	136.8	136.8	136.8
INTEREST EXPENSE	84.4	252.5	250.2	261.9	248.8	235.0
TOTAL EXPENSES	179.4	527.9	524.7	553.9	538.5	522.4
STATUTORY INCOME TAXES	(5.3)	196.5	198.2	321.6	329.7	338.2
NET INCOME	(4.7)	175.0	176.5	286.3	293.6	301.2
ACCUMULATIVE RATE OF RETURN %	3.7	6.2	6.5	6.7	6.8	6.9

ACCUMULATIVE RATES OF RETURN SHOWN FOR 1977-1979 PERIOD REFLECT CARRYBACK INCOME FROM 1980-1982 PERIOD AS PROVIDED FOR UNDER THE TERMS OF THE 1941 ELKINS ACT CONSENT DECREE.

Response of Sohio to June 2 Request.

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SCHEDULE II

SOHIO PIPE LINE COMPANY

TAPS TARIFF BASIS

PROJECTED TAPS THROUGHPUT SCHEDULE (OIL + CONDENSATE)

	000'S BPD
SEPT. 1977	400
OCT. 1977	600
NOV. 1977	800
DEC. 1977	900
1978	1200
1979	1200
1980	1550
1981	1550
1982	1550

THE ABOVE SCHEDULE REPRESENTS SOHIO'S MOST OPTIMISTIC TAPS THROUGHPUT PROJECTION BASED ON THE FOLLOWING ASSUMPTIONS:

- INITIAL LIFTINGS FROM THE TAPS TERMINAL AT VALDEZ TO OCCUR BY SEPTEMBER 1, 1977, AND THE EXPANSION (PHASE III) OF TAPS TO 1,550,000 BARRELS PER DAY OPERATIONAL JANUARY 1, 1980.
- THROUGHPUT LEVELS FOR 1980 - 1982 PERIOD PREDICATED ON A MAXIMUM EFFICIENT RATE (MER) OF 1,500,000 BARRELS PER DAY PLUS CONDENSATE PRODUCTION OF 50,000 BARRELS PER DAY.

Response of Sohio to June 2 Request.

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SCHEDULE III

SOHIO PIPE LINE COMPANY

TAPS TARIFF BASIS

DEBT ISSUES & INTEREST EXPENSE
(MILLIONS OF DOLLARS)

			YEARLY INTEREST							
DEBT ISSUE	RATE	AMOUNT	PRIOR TO 1977	1/1/77-8/31/77	9/1/77-12/31/77	1978	1979	1980	1981	1982
REVOLVING CREDIT	8.925%	135.0			4.03	11.87	9.56	6.73	3.89	1.06
LONG TERM DEBT #1	9.75%	169.5			5.53	16.60	16.60	16.54	16.38	16.21
LONG TERM DEBT #2	8.625%	169.5			4.92	14.78	14.78	14.78	14.78	14.78
LONG TERM DEBT #3	10.625%	552.9			19.61	58.85	58.85	57.98	53.66	49.05
LONG TERM DEBT #4	10.625%	633.6			22.47	67.41	67.41	66.70	63.14	59.34
LONG TERM DEBT #5	8.75%	250.0			7.33	22.01	22.01	22.01	22.01	22.01
LONG TERM DEBT #6	9.75%	339.0			11.18	33.13	33.13	32.67	30.43	28.04
LONG TERM DEBT #7	6.00%	455.0			9.28	27.83	27.83	27.83	27.83	27.83
EXPANSION DEBT	9.5%	175.0			--	--	18.50	16.68	16.68	16.68
	9.3%	2879.5			84.35	252.48	268.67	261.92	248.80	235.01
TOTAL INTEREST CAPITALIZED			314.9	181.50			18.50			
TOTAL INTEREST EXPENSED					84.35	252.48	250.17	261.92	248.80	235.01

LONG TERM DEBT #7 REPRESENTS VALDEZ REVENUE BONDS.
EXPANSION DEBT IS AN ESTIMATE OF SOHIO'S BORROWED CAPITAL REQUIREMENT FOR TAPS PHASE III EXPANSION.
LONG TERM DEBT AND REVOLVING CREDIT GUARANTEED BY THE STANDARD OIL COMPANY.

Response of Sohio to June 2 Request.

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SCHEDULE IV

SOHIO PIPE LINE COMPANY

TAPS TARIFF BASIS

OPERATING EXPENSES
(MILLIONS OF DOLLARS)

	1977	1978	1979	1980	1981	1982
DIRECT OPERATING EXPENSES	$ 32.2	78.2	78.2	83.6	83.6	83.6
SOHIO CORPORATE SERVICES AND INSURANCE	1.6	5.0	5.0	5.0	5.0	5.0
RIGHT-OF-WAY EXPENSE	0.3	1.0	1.0	1.0	1.0	1.0
DISMANTLING AND RESTORATION EXPENSE	4.7	14.0	14.0	14.0	14.0	14.0
TOTAL	38.8	98.2	98.2	103.6	103.6	103.6

DIRECT OPERATING EXPENSES BASED UPON ALYESKA'S 1977 - 1976 PROJECTED COSTS. YEARLY ADJUSTMENTS HAVE BEEN MADE BY SOHIO FOR FUEL AND POWER CONSUMPTION AND COSTS. THE ABOVE OPERATING COSTS HAVE NOT BEEN ESCALATED FOR THE PERIOD 1979 - 1982 DUE TO BOTH THE UNCERTAINTY OF THE EXTENT OF FUTURE INFLATION AND THE LEVEL OF ACTUAL OPERATING COSTS FOR TAPS AFTER EXPANSION.

DISMANTLING AND RESTORATION EXPENSE ESTIMATED AT $1.05 BILLION (1977 $) BY ALYESKA AND HAS BEEN ACCRUED BY SOHIO AT ANNUAL RATE OF $14 MILLION PER YEAR.

Response of Sohio to June 2 Request.

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SCHEDULE V

SOHIO PIPE LINE COMPANY
TAPS TARIFF BASIS

VALUATION SCHEDULE
(MILLIONS OF DOLLARS)

	PRIOR TO 9/1/77	9/1/77 TO 12/31/77	1978	1979	1980	1981	1982
VALUATION BASIS							
CAPITAL EXPENDITURES							
TAPS - PHASE I/II	$2534.8	$48.1	$30.5	-	-	-	-
TAPS - PHASE III EXPANSION	-	-	-	$208.4	-	-	-
CAPITALIZED TAXES & OVERHEAD	59.2	-	-	-	-	-	-
CAPITALIZED INTEREST							
TAPS @ 1200 MBPD CAPACITY	496.4	-	-	-	-	-	-
TAPS PHASE III EXPANSION	-	-	-	18.5	-	-	-
TOTAL	3090.4	48.1	30.5	226.9	0	0	0
"GOING CONCERN" VALUE	3275.8	3302.0	3266.5	3428.1	3359.5	3292.3	3226.5
WORKING CAPITAL	13.0	13.0	16.0	16.0	16.0	16.0	16.0
VALUATION @ END OF PERIOD	3288.8	3315.0	3282.5	3444.1	3375.5	3308.3	3242.5
CAPITAL REQUIREMENT/SOURCE							
REQUIREMENT: CAPITALIZED		3138.5	30.5	226.9			
WORKING		13.0	3.0	0.0			
TOTAL		3151.5	33.5	226.9			
CAPITAL SOURCE							
BORROWED		2707.5	(8.2)	143.3			
EQUITY		444.0	41.7	83.6			
TOTAL		3151.5	33.5	226.9			

CAPITALIZED TAXES AND OVERHEAD INCLUDES AD VALOREM TAXES ($26.8) INCURRED PRIOR TO 1977 AND OVERHEAD ($3.0) PRIOR TO STARTUP.

TREATMENT OF VALUATION IN FUTURE YEARS WAS BASED UPON A TRADITIONAL 2% ANNUAL DECLINE RATE. WHILE THIS REPRESENTS A CONSERVATIVE HANDLING OF VALUATION IT WAS USED FOR PURPOSES OF THIS SCHEDULE BECAUSE OF THE UNKNOWN EXTENT OF FUTURE INFLATION.

Response of Sohio to June 2 Request.

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SCHEDULE VI

SOHIO PIPE LINE COMPANY

TAPS TARIFF BASIS

DEPRECIATION AND AD VALOREM TAX
(MILLIONS OF DOLLARS)

	1977	1978	1979	1980	1981	1982
DEPRECIATION BY CATEGORY						
CAPITAL EXPENDITURES	$ 34.12	$103.95	$104.58	$113.77	$113.77	$113.77
CAPITALIZED TAXES & OVERHEAD	0.79	2.37	2.37	2.37	2.37	2.37
CAPITALIZED INTEREST	6.62	19.86	19.86	20.68	20.68	20.68
TOTAL DEPRECIATION	$ 41.53	$126.18	$126.81	$136.82	$136.82	$136.82
AD VALOREM TAX						
PROPERTY, PLANT & EQUIPMENT (PRIOR YEAR END)	$2202.9	$2548.8	$2475.3	$2579.1	$2465.3	$2351.5
PLUS ADDITIONAL CAPITAL EXPENDITURES	380.0	30.5	208.4	-	-	-
LESS DEPRECIATION ON NET PROPERTY	34.1	104.0	104.6	113.8	113.8	113.8
NET PROPERTY (YEAR END)	2548.8	2475.3	2579.1	2465.3	2351.5	2237.7
AD VALOREM TAXES (EXPENSED)	14.7	51.0	49.5	51.6	49.3	47.0
AD VALOREM TAXES (CAPITALIZED)	29.4	-	-	-	-	-

DEPRECIATION BASED UPON 25 YEAR STRAIGHT LINE.

AD VALOREM TAXES BASED ON 2% OF PRIOR YEAR PROPERTY, PLANT, AND EQUIPMENT

Response of Sohio to June 2 Request.

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SECTION II

ALTERNATE CASE INFORMATION

1) Valuation Not Declined

2) Working Capital increased to $16.0 MM in 1980 vice 1979

**Response of Union Alaska Pipeline Co.
to June 2 Request, June 15, 1977.**

[LETTERHEAD OF UNION ALASKA PIPELINE COMPANY]

June 14, 1977

Interstate Commerce Commission
Washington, D.C. 20423

Gentlemen:

Pursuant to the Commission's notice dated June 2, 1977, please find attached the basis for the computation of the Union Alaska Pipeline Company tariff rate issued on June 15, 1977 and effective on June 30, 1977. The tariff and rate computations were prepared by Mr. L. F. Grandey, Vice President, Union Alaska Pipeline Company.

Very truly yours,

DAVID M. SCHWARTZ
SULLIVAN AND WORCESTER
1025 Connecticut Avenue, N.W.
Suite 500
Washington, D.C. 20036
(202) 293-6170
Attorney for Union Alaska
Pipeline Company

DMS:sky

cc: John M. Cleary, Esquire
Attorney for the State of Alaska

Response of Union Alaska to June 2 Request.

UNION ALASKA PIPELINE COMPANY
TARIFF CALCULATIONS
BASED ON THROUGHPUT AND EXPENSES
DURING THE PERIOD 9/1/77—12/31/77

1. Maximum Allowable 7% Consent Decree Net Income

		$
Construction cost $7,761.5 million × 0.0166	=	128,841,000
Capitalized start-up costs $245.9 million × 0.0166	=	4,082,000
Capitalized interest on financing thru 8/31/77	=	10,600,000
Capitalized supplies $40.0 million × 0.0166	=	664,000
Total		144,187,000
$144,187,000 × (0.07 × 122 days / 365 days)	=	$3,374,000

2. Interest Expense
(Medium and long-term notes @ 8.3% interest rate)
$83,125,000 × (0.083 × 120 days / 360 days) = 2,300,000
(Short-term paper @ 5.4% interest rate)
$45,314,000 × (0.054 × 120 days / 360 days) = 837,000
Total $3,137,000
(360 days in banking year—30 days/month)

3. Depreciation (25-year life)
$144,187,000 ÷ 25 years × 122 days / 365 days) = $1,928,000

4. Reserve For Restoration
$1,049,000,000 × 0.0166 ÷ 25 years × 122 days / 365 days) = $ 232,000

5. Operating Expense
Total $141,807,000 × 0.0166 = $2,354,000

$

6. Federal and State Income Tax
Federal 48.0%
State of Alaska 9.36%
Effective rate: (0.0936) + (0.48 − 0.0936 × 0.48) = 0.5287
$3,374,000 / (1-0.5287) (allowable net income) = $7,159,000 (income before tax)
Taxes: $7,159,000 $3,374,000 $3,785,000

7. Consolidation

Net Income	$3,374,000
Interest Expense	3,137,000
Depreciation Expense	1,928,000
Reserve For Restoration	232,000
Operating Expense	2,354,000
Income Taxes	3,785,000
Total	$14,810,000

8. Tariff
$14,810,000 ÷ 2,430,240 barrels (19,920 b/d) = $6.09/bbl.
(expected shipments)

Response of Union Alaska to June 2 Request.

UNION ALASKA PIPELINE COMPANY TAPS TARIFF ASSUMPTIONS

1977
(M$)

Assumption	Union Alaska Pipeline Company	Total Line	Source
1. Ownership	1.66%	100%	—
2. Start-up Date	9/1/77	9/1/77	Alyeska 5/19/77
3. Construction Cost(a)	128,841	7,761,500	Alyeska 5/19/77
4. Start-up Cost(a)	4,082	245,900	Alyeska 5/19/77
5. Maintenance Supplies(a)	664	40,000	Alyeska
6. Interest Expense to 8/31/77(a)	10,600	—	UA P/L Estimate
7. Depreciable Amount	144,187	—	Sum of 3, 4, 5, & 6
8. ICC 1977 Valuation	144,187	—	UA P/L Estimate
9. Operating Expense 1977(b)	2,354	141,807	Alyeska 5/19/77
10. Interest Rate 1977(b)	83,125 @ 8.3 %	—	UA P/L Estimate
	45,314 @ 5.45%	—	UA P/L Estimate
11. Restoration Reserve	1,741	1,049,000	Alyeska 5/19/77
12. Provision for Restoration(b)	232	14,020	1/25 per year
13. Income Tax Rates	Fed. 48%; Alaska 9.36%	—	UA P/L Estimate
14. Book Depreciation	25 year S/L	—	Expected ICC ruling
15. Line Capacity(b)	19,920 B/D	1,200,000 BD	—
16. Expected thruput(b)	19,920 B/D	—	UA P/L Estimate

(a) Capitalized
(b) 9/1/77-12/31/77

Response of BP Pipelines Inc. to Request for Tariff Data, June 17, 1977.

[Caption Omitted in Printing.]

RESPONSE OF BP PIPELINES INC.
TO ICC NOTICE DATED JUNE 2, 1977 TO
TRANS ALASKA PIPELINE SYSTEM OWNERS

BP Pipelines Inc. ("BP") issued its Local Pipeline Tariff 2 on June 3, 1977, effective June 20, 1977, later postponed with special permission of the Commission to June 30, 1977, applying to the interstate transportation of petroleum from Prudhoe Bay, Alaska to marine vessels at Valdez Terminal, Alaska with a tariff rate of $6.35 per barrel.

In its notice dated June 2, 1977, the ICC requested the basis of computation of the initial rate level. BP's tariff of $6.35 was not based solely on the computation of costs but was selected on the basis of a number of considerations. Among these were the overall risks and uncertainties of its participation in the project, including competition from other TAPS carriers, possible increases in operating costs and variations in throughput due to regulatory and marketing constraints (such as the availability of suitable tankers to handle the pipeline shipments over BP's space) and the physical capability of TAPS and the Prudhoe Bay production facilities to operate at all times under the hostile Arctic environment. BP also considered the need to provide adequate funds to cover its debt service requirements particularly for the early years. BP believes its interest costs are substantially higher than most of the other owner companies. In addition to normal operating costs associated with an oil pipeline's operation, BP also had to consider the need to provide funds for system dismantling and environmental restoration at the completion of the project.

In the following paragraphs the computations of each of BP's major cost elements are explained. Costs have been

estimated for three separate periods all starting from August 1, 1977, the estimated commencement of operations. The first extends to the end of 1977, the second through the first full calendar year of operation and the third through 1981. The later period assumes an expansion to 1.6 million barrels per day in January 1980. Following these explanations are estimates of the results of operations for these periods. Although, at the present time, BP cannot reasonably estimate its throughput volumes, it has assumed, for this presentation, full throughput for these periods except during the build-up to 1.2 million barrels per day over 1977.

The costs presented are the best estimates available at this time. BP recognizes that its tariff may need to be revised in the light of actual operation condition. This has been the experience of other large pipeline ventures.

Estimated Operating Expenses

Operating Expenses, excluding depreciation, are shown on Exhibit A for the three periods noted above and are comprised of BP's share (15.84%) of Alyeska's costs, and BP's direct costs. The Alyeska cost estimates for 1977 and 1977/1978 period are those presented to the TAPS owners on May 19, 1977 as Alyeska's preliminary operating budgets. For the remaining years of the 1977/1981 period BP projected operating costs reflecting changes in price levels and the effect of increased throughput in the later years. Presently, these estimated expenses do not include an allowance for the risk of liability for environmental damage.

Estimated Depreciation Expense

Depreciation Expense (see Exhibit B), is computed on a straight-line basis. The estimated service lives for the following Accounts are: 163, Communication Systems, 10 years; 164, Office Furniture and Equipment, 25 years; 165, Vehicles and Other Work Equipment, 5 years. Account 151, Land, is not depreciated. All other accounts are depreciated over an estimated economic life of 25 years for the entire project. The economic life is the estimated period over which the known recoverable reserves tributary to TAPS will be depleted to a point where further oil production and transportation will cease to be economically feasible.

The depreciation rates developed from the above lives were applied to the estimated original costs of Alyeska and BP. The cost of assembling and transporting the materials to be removed from the remote location of TAPS to a disposal point is expected to at least equal, and possibly exceed, the estimated amounts to be received from salvage sales. Therefore, the salvage credits are assumed to be zero.

Estimated Dismantling and Environmental Restoration Costs

In addition to the estimated costs normally classified in Accounts 300 to 580 (Operations, Maintenance and General Expenses), an accrual is also included for the estimated cost of dismantling the facilities and for environmental restoration. This work is required by the right-of-way agreements with the United States Department of Interior and the State of Alaska. An estimate of these costs, in 1977 dollars, has been prepared by independent contractors to Alyeska. BP's share of the total estimated cost is $166 million (see Exhibit C). The amounts shown on Exhibit C represent, for each period, the ratable portion (computed on a straight-line basis over 25 years) of this estimated cost

adjusted where appropriate for estimated price level changes.

Estimated Income Taxes

Estimated amounts for income taxes were calculated at the composite statutory Federal and State income tax rates. In computing the taxes, interest expense was deducted from the estimated net carrier operating income. The interest rates payable by BP vary from 1.18 times the prime lending rate of Morgan Guaranty Trust Company to 10⅝%. All of BP's borrowings are guaranteed by BP's parent, The British Petroleum Company Limited. The details of these borrowings and related interest were presented in BP's response of March 14, 1977 to Mr. J. R. Berman, Chief, Section of Audit.

Estimated Valuation

Whereas BP agrees with the principles employed in the ICC valuation process, it has expressed, in the Ex Parte 308 proceeding, its concern that the use of certain factors do not reflect current economic conditions. BP is hopeful that refinements of these factors will be adopted.

In computing its estimated valuation, BP has followed the current ICC procedures, in accordance with the instructions of Mr. William T. Bono in his letter dated April 22, 1977, and as detailed in the testimony of Mr. Jesse C. Oak, Senior Valuation Engineer, in Ex Parte 308 and has included the following:

(1) The cost of reproduction new was computed from the original costs by vintage year of expenditure.

(2) Working Capital was computed as 15 days' of estimated cash operating expenses plus an estimated balance of operating Materials and Supplies.

(3) The annual and period indices for the years 1976 through 1981 were projected from the 1975 indices (the latest available indices issued by ICC at the time of this calculation) assuming a continuation of increases in price levels.

The estimated valuation at December 31, 1977, $1,548 million (see Exhibits D, E, F and G), was derived from the combined estimated original costs of BP's share ($1,259 million) of the Alyeska total estimated project capitalized cost of $7,950 million, (see footnote on page 1 of Exhibit E) together with the Company-incurred capital costs (principally financing and overhead costs) of $204 million. The overhead amounts included in the cost of reproduction new and the cost of reproduction new less depreciation were derived using the following percentage factors:

Overheads	1½%	
Engineering Services	1½%	
Interest	11.75%	(6% annual rate for 23.5 months)

Similar calculations of cost of reproduction new were made for subsequent years.

BP's estimated original cost includes an allowance for interest on only the debt funds used during construction and not on the total funds employed. This was predicated on the assumption of the continuation of the current ICC valuation process.

Summary

Although the projected throughput volumes of BP are subject to a number of factors outside its control, BP, for this presentation, is showing the estimated operating

results under the optimistic assumption of full throughput except for the start-up period. No allowance has been made for shut-downs due to mechanical failures, lifting delays, or the inability of the system to deliver its nominal design capacity.

Based on a $6.35 tariff, the estimated operating results for the three periods may be summarized as follows ($million, unless otherwise indicated):

	1977	1977/1978	1977-1981
Volumes Delivered (million barrels)	20	89	334
Operating Revenues	127.0	565.2	2120.9
Operating Expenses:			
Depreciation	24.9	84.7	273.7
Dismantling & Restoration	2.8	10.0	35.5
Other Operating Expenses	27.6	92.4	307.5
Net Carrier Operating Income	71.7	378.1	1504.2
Interest Expense	47.9	166.8	488.9
Income Tax	12.6	111.8	537.0
Net Income	11.2	99.5	487.3
% Return on Valuation	1.7	4.5	7.0

From the above it can be seen that at a tariff rate of $6.35 per barrel, BP might just be able to cover its debt servicing requirement in 1977 although any reduction in BP's throughput would jeopardize this ability. Further, at the proposed tariff and with the throughput assumptions used, it would only be over the 1977-1981 period, taken as a whole, that BP would achieve a level of net income which BP believes to be commensurate both with the risks

involved and also with current practice. The alternative would have been to have filed a higher tariff in the initial period. BP considers it reasonable, though not without risk for BP, to spread the initial tariff over an extended period and thereby pass on to all shippers from the outset the benefit of the anticipated expansion. This approach also results in BP's initial shippers not having to bear all of the higher initial costs.

BP Pipelines Inc.
by D. A. Lucas
Manager of Transportation

Response of BP Pipelines to Request for Tariff Data.

BP PIPELINES INC.

EXHIBITS

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	EXHIBIT
Estimated Operating Expenses	A
Estimated Depreciation Expense	B
Provision for Estimated Dismantling and Environmental Restoration Costs	C
Estimated Valuation	D
Estimated Original Cost of Initial Project and Project Expansion	E
Estimated Cost of Reproduction New	F
Estimated Working Capital	G

Response of BP Pipelines to Request for Tariff Data.

EXHIBIT A

BP PIPELINES INC.

ESTIMATED OPERATING EXPENSES
FOR THE PERIODS BEGINNING AUGUST 1, 1977
AND ENDING DECEMBER 31, 1977, 1978 AND 1981,
($000)

LINE NO	DESCRIPTION (a)	DEPRECIATION EXPENSES (b)	DISMANTLING & ENVIRONMENTAL RESTORATION COSTS (c)	PIPELINE TAXES (d)	FUEL AND POWER (e)	ALL OTHER OPERATING EXPENSES (f)	TOTAL (g)
1	August 1 Through December 31, 1977						
2	BP Pipelines' Portion of Alyeska Costs	$ -	$ 2,769	$ 8,218	$ 1,629	$ 16,150	$ 28,766
3	BP Pipelines' Direct Costs	24,917	-	4	500	1,154	26,575
4	Total	$ 24,917	$ 2,769	$ 8,222	$ 2,129	$ 17,304	$ 55,341
5	August 1, 1977 Through December 31, 1978						
6	BP Pipelines' Portion of Alyeska Costs	$ -	$ 9,956	$ 34,416	$ 4,884	$ 46,509	$ 95,765
7	BP Pipelines' Direct Costs	84,711	-	112	2,235	4,256	91,314
8	Total	$ 84,711	$ 9,956	$ 34,528	$ 7,119	$ 50,765	$ 187,079
9	August 1, 1977 Through December 31, 1981						
10	BP Pipelines' Portion of Alyeska Costs	$ -	$ 35,493	$113,195	$ 16,294	$152,952	$ 317,934
11	BP Pipelines' Direct Costs	273,693	-	491	9,475	15,132	298,791
12	Total	$273,693	$ 35,493	$113,686	$ 25,769	$168,084	$ 616,725

Response of BP Pipelines to Request for Tariff Data.

BP PIPELINES INC.

ESTIMATED DEPRECIATION EXPENSE
FOR THE PERIODS BEGINNING AUGUST 1, 1977
AND ENDING DECEMBER 31, 1977, 1978 AND 1981
($000)

EXHIBIT B

Line No.	Account No.	Account Title	Estimated Depreciable Value December 31, 1977	Estimated Depreciable Value December 31, 1980	Depreciation Rate	Depreciation Expense August 1, 1977 Through December 31, 1977	1978	1981
	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
1	152	Rights of Way	$ 165	$ 165	4%	$ 3	$ 9	$ 27
2	153	Line Pipe	31,308	31,308	4%	522	1,774	5,530
3	154	Line Pipe Fittings	6,909	6,909	4%	115	391	1,219
4	155	Pipeline Construction	1,025,262	1,025,262	4%	17,088	58,098	181,128
5	156	Buildings	42,228	42,228	4%	704	2,393	7,460
6	157	Boilers	2,192	2,192	4%	37	125	389
7	158	Pumping Equipment	13,987	22,000	4%	233	792	3,179 1/
8	160	Other Station Equipment	88,479	141,698	4%	1,475	5,014	20,361 1/
9	161	Oil Tanks	8,440	13,782	4%	141	479	1,967 1/
10	162	Delivery Facilities	232,672	274,298	4%	3,878	13,195	44,792 1/
11	163	Communications Systems	502	502	10%	21	71	221
12	164	Office Furniture & Equipment	167	167	4%	3	10	31
13	165	Vehicles & Other Work Equipment	8,365	8,365	20%	697	2,370	7,359
14		Total	$1,460,676	$1,569,076		$24,917	$84,711	$273,693

Notes: 1/ Includes Depreciation of Expansion Facilities over 22 years, 7 months remaining life (4.428%).

EXHIBIT C

BP PIPELINES INC.

PROVISION FOR ESTIMATED DISMANTLING
AND ENVIRONMENTAL RESTORATION COSTS
FOR THE PERIODS BEGINNING AUGUST 1, 1977
AND ENDING DECEMBER 31, 1977, 1978 AND 1981
($000)

Line No.	Description	Alyeska Costs 100%	BP Pipelines' Share 15.84%
	(a)	(b)[1]	(c)[1]
1	Displace, Clean and Purge	$ 90,000	$ 14,256
2	Pipeline and Pump Stations	564,000	89,338
3	Terminal	245,000	38,808
4	Alyeska Corporate Administration	150,000	23,760
5	Total	$1,049,000	$166,162
6	Accrual of Cost:[2]		
7	August 1, 1977 through December 31, 1977		$ 2,769
8	August 1, 1977 through December 31, 1978		$ 9,956
9	August 1, 1977 through December 31, 1981		$ 35,493

NOTES:

1. In 1977 Dollars.
2. Based on 25 Year Total Accrual Period, with Amounts After 1977 Adjusted for Expected Changes in Price levels.

Response of BP Pipelines to Request for Tariff Data.

BP PIPELINES INC. EXHIBIT D

ESTIMATED VALUATION
AT DECEMBER 31, 1977
($000)

Line No.	Description	December 31, 1977
	(a)	(b)
1	Original Cost[1]	$1,460,511
2	Cost of Reproduction New[1]	1,439,361
3	Total	$2,899,872
4	Cost of Reproduction New, Less Depreciation[1]	$1,439,361
5	Ratio of Line 1 to Line 3	50.3647%
6	Ratio of Line 2 to Line 3	49.6353%
7	Product of Line 1 x Line 5	735,582
8	Product of Line 2 x Line 6	714,431
9	Total (Line 7 + Line 8)	$1,450,013
10	Condition Percent (Line 4 ÷ Line 2)	100%
11	Value of Depreciable Property (Line 9 x Line 10)	1,450,013
12	Present Value of Land (Original Cost x 50%)	1,247
13	Present Value of Rights of Way (Original Cost x 50%)	83
14	Working Capital	9,321
15	Total Tangible Value (Lines 11 + 12 + 13 + 14)	1,460,664
16	Going Concern and Other Intangibles (Line 11 x 6%)	87,001
17	Final Value of Property Owned & Used	1,547,665
18	Less Property Constructed with Excess Earnings	—
19	Total Estimated Valuation	$1,547,665

NOTE:
1. Excluding Land & Rights of Way.

Response of BP Pipelines to Request for Tariff Data.

EXHIBIT E
PAGE 1 OF 2

BP PIPELINES INC.

ESTIMATED ORIGINAL COST OF INITIAL PROJECT
AT DECEMBER 31, 1977
($000)

Line No.	Account No.	Title	December 31, 1977
	(a)	(b)	(c)
1	151	Land	$ 2,494
2	152	Rights of Way	165
3	153	Line Pipe	31,308
4	154	Line Pipe Fittings	6,909
5	155	Pipeline Construction	1,025,262
6	156	Buildings	42,228
7	157	Boilers	2,192
8	158	Pumping Equipment	13,987
9	160	Other Station Equipment	88,479
10	161	Oil Tanks	8,440
11	162	Delivery Facilities	232,672
12	163	Communications Systems	502
13	164	Office Furniture & Equipment	167
14	165	Vehicles & Other Work Equipment	8,365
15		Total Original Cost	$1,465,170[1]
16		Total Excluding Land	$1,460,676
17		Total Excluding Land and Rights of Way	$1,460,511

NOTE:
1. Includes estimated Alyeska costs based on Project budget approved April 14, 1977. Subsequent revisions are anticipated.

Response of BP Pipelines to Request for Tariff Data.

EXHIBIT E
PAGE 2 OF 2

BP PIPELINES INC.

ESTIMATED ORIGINAL COST OF PROJECT EXPANSION
AT ESTIMATED COMPLETION DATE, JANUARY 1, 1980
($000)

	Account No.	Account Title	Amount
	(a)	(b)	(c)
1	158	Pumping Equipment	$ 8,013
2	160	Other Station Equipment	53,419
3	161	Oil Tanks	46,968
		Total	$ 108,400

Response of BP Pipelines to Request for Tariff Data.

EXHIBIT F
PAGE 1 OF 5

BP PIPELINES INC.

ESTIMATED COST OF REPRODUCTION NEW
AT DECEMBER 31, 1977
($000)

	Account No.	Account Title	Amount
	(a)	(b)	(c)
1	153	Line Pipe	$ 53,090
2	154	Line Pipe Fittings	12,077
3	155	Pipeline Construction	1,041,116
4	156	Buildings	63,265
5	157	Boilers	3,564
6	158	Pumping Equipment	13,932
7	160	Other Station Equipment	140,192
8	161	Oil Tanks	56,711
9	162	Delivery Facilities	37,936
10	163	Communication Systems	512
11	164	Office Furniture and Equipment	170
12	165	Vehicles and Other Work Equipment	16,796
13		Total Cost of Reproduction New Excluding Land and Right-of-Way	$1,439,361

BP PIPELINES INC.

Computation of Estimated Cost of Reproduction New - Initial Project
at December 31, 1977 through 1981
($000)

EXHIBIT F
Page 2 of 5

Line No.	Year (a)	Carrier Property Accounts 152 (b)	154 (c)	155 (d)	156 (e)	157 (f)	158 (g)	160 (h)	161 (i)	162 (j)	163 (k)	164 (l)	165 (m)	Total (n)
1	Original Cost Less Overheads													
2	1969	2,217	---	1,900	475	---	---	---	---	---	---	---	---	4,592
3	1970	12,989	---	12,356	475	---	---	---	---	---	---	---	---	25,820
4	1971	4,435	475	7,603	159	---	---	1,109	---	---	---	---	---	13,781
5	1972	---	---	3,009	---	---	---	792	158	159	---	---	---	4,118
6	1973	---	---	1,742	317	---	(158)	159	158	159	---	---	---	2,377
7	1974	---	634	110,564	6,494	158	1,109	4,435	2,693	950	---	---	158	127,195
8	1975	2,693	2,376	343,886	14,889	1,109	4,594	20,434	12,989	7,445	---	---	3,960	414,375
9	1976	2,218	6,335	280,210	22,652	1,268	5,226	43,401	19,959	15,206	---	---	3,643	400,118
10	1977	---	---	88,862	6,970	475	317	52,430	12,514	8,871	475	158	7,128	178,200
11	Total	24,552	9,820	850,132	52,431	3,010	11,088	122,760	48,471	32,790	475	158	14,889	1,170,576
12	Annual Indices													
13	1969	193	193	169	219	200	201	233	229	210	187	169	171	
14	1970	200	200	176	225	203	201	241	253	223	192	172	179	
15	1971	215	215	191	196	221	206	249	274	225	198	177	186	
16	1972	219	219	204	208	232	209	259	293	236	204	179	191	
17	1973	235	235	219	224	250	215	273	300	248	213	188	194	
18	1974	299	299	242	265	300	244	310	361	290	233	207	210	
19	1975	409	409	269	273	330	305	373	410	336	249	236	250	
20	1976	434	434	285	289	350	354	395	435	356	264	250	265	
21	1977	469	469	308	312	378	382	427	470	384	285	270	286	
22	1978	507	507	333	337	408	413	461	508	415	308	292	309	
23	1979	548	548	360	364	441	446	498	549	448	333	315	334	
24	1980	592	592	389	393	475	482	538	593	484	360	340	361	
25	1981	639	639	420	424	514	521	581	640	523	389	367	390	

BP PIPELINES INC.

Computation of Estimated Cost of Reproduction New - Initial Project
at December 31, 1977 through 1981
($000)

EXHIBIT F
Page 3 of 5

Line No.	Year (a)	Carrier Property Accounts 152 (b)	154 (c)	155 (d)	156 (e)	157 (f)	158 (g)	160 (h)	161 (i)	162 (j)	163 (k)	164 (l)	165 (m)	Total (n)
1	1947 Price Value													
2	1969	1,149	---	1,124	217	---	---	---	---	---	---	---	---	2,490
3	1970	6,495	---	7,020	211	---	---	---	---	---	---	---	---	13,726
4	1971	2,063	221	3,981	81	---	---	445	---	---	---	---	---	6,791
5	1972	---	---	1,475	---	---	---	306	54	67	---	---	---	1,902
6	1973	---	---	795	142	---	(73)	58	53	64	---	---	---	1,039
7	1974	---	212	43,688	2,451	33	455	1,431	746	328	---	---	75	51,439
8	1975	658	581	127,839	5,454	336	1,476	5,478	3,168	2,216	---	---	1,584	148,790
9	1976	511	1,460	98,319	7,838	362	1,618	10,908	4,588	4,271	---	---	1,375	131,330
10	1977	---	---	28,851	2,234	126	83	12,279	2,663	2,310	166	59	2,492	51,263
11	Total	10,876	2,474	315,092	18,628	877	3,559	30,985	11,772	9,256	166	59	5,526	409,770
12	Period Indices													
13	1977	424	424	287	295	353	340	393	437	356	268	251	264	
14	1978	473	473	311	315	381	380	431	474	388	288	273	289	
15	1979	510	510	335	339	411	415	464	511	417	310	293	311	
16	1980	551	551	362	366	443	449	501	552	451	335	317	336	
17	1981	595	595	391	395	479	485	541	596	487	362	342	363	
18	Current Year CRN Excluding Overheads													
19	1977	46,114	10,490	904,314	54,952	3,096	12,101	121,771	49,259	32,951	445	148	14,589	1,250,230
20	1978	51,443	11,702	979,936	58,678	3,341	13,524	133,545	53,429	35,913	478	161	15,970	1,358,120
21	1979	55,468	12,617	1,055,558	63,149	3,604	14,770	143,770	57,600	38,598	515	173	17,186	1,463,003
22	1980	59,927	13,632	1,140,363	71,838	3,885	15,980	155,235	62,221	41,745	556	187	18,567	1,584,136
23	1981	64,712	14,720	1,232,010	73,581	4,201	17,261	167,629	67,181	45,077	601	202	20,059	1,707,234

Response of BP Pipelines to Request for Tariff Data.

EXHIBIT F
Page 4 of 5

BP PIPELINES INC.

Computation of Estimated Cost of Reproduction New - Pattern Project
at December 31, 1977 through 1981
($000)

Line No.	Year (a)	Carrier Property Accounts 152 (b)	154 (c)	155 (d)	156 (e)	157 (f)	158 (g)	160 (h)	161 (i)	Total (o)
1	Current Year CRN Including Overheads (@ 1.131276438)									
2	1977	53,090	12,077	1,041,116	63,265	3,564	13,932	140,192	56,711	1,439,361
3	1978	59,225	13,472	1,128,177	67,555	3,847	15,570	153,747	61,512	1,464,115
4	1979	63,859	14,526	1,215,239	72,702	4,149	17,004	165,519	66,314	1,487,227
5	1980	68,993	15,694	1,312,873	82,705	4,473	18,397	178,718	71,634	1,320,183
6	1981	74,301	16,947	1,418,384	84,712	4,837	19,872	192,987	77,344	1,341,254
7	Condition Percent									
8	1977	100	100	100	100	100	100	100	100	
9	1978	94	94	94	93	93	93	94	93	
10	1979	89	89	89	87	87	87	89	87	
11	1980	84	84	84	82	82	82	84	82	
12	1981	79	79	79	77	77	77	79	77	
13	Current Year CRN Less Depreciation									
14	1977	53,090	12,077	1,041,116	63,265	3,564	13,932	140,192	56,711	1,439,361
15	1978	55,672	12,664	1,060,486	62,826	3,578	14,480	144,322	57,308	1,464,115
16	1979	56,335	12,920	1,081,563	63,231	3,610	14,793	147,312	57,693	1,487,227
17	1980	57,954	13,183	1,102,813	67,818	3,668	15,086	150,123	58,240	1,320,183
18	1981	58,836	13,308	1,120,323	65,228	3,724	15,301	152,460	59,353	1,341,254

Response of BP Pipelines to Request for Tariff Data.

EXHIBIT F

PAGE 5 OF 5

BP PIPELINES INC.

COMPUTATION OF ESTIMATED COST OF
REPRODUCTION NEW (CRN)
PROJECT EXPANSION
AT DECEMBER 31, 1980 AND 1981
($000)

Carrier Property Account

Line No.	Year	158	160	161	Total
1	Original Cost Less Overheads				
2	1980	$7,098	$47,317	$41,560	$ 95,975
3	Annual Indices				
4	1980	482	538	593	
5	1947 Price Value				
6	1980	1,473	8,795	7,008	17,276
7	Period Indices				
8	1980	449	501	552	
9	1981	485	541	596	
10	Current Year CRN Excluding Overheads				
11	1980	6,614	44,063	38,684	89,361
12	1981	7,144	47,581	41,768	96,493
13	Current Year CRN Including Overhead (@ 1.120369688)				
14	1980	7,410	49,367	43,340	100,117
15	1981	8,004	53,308	46,796	108,108
16	Condition Percent				
17	1980	100	100	100	
18	1981	93	94	93	
19	Current Year CRN Less Depreciation				
20	1980	7,410	49,367	43,340	100,117
21	1981	$7,444	$50,110	$43,520	$101,074

Response of BP Pipelines to Request for Tariff Data.

EXHIBIT G

BP PIPELINES INC.

ESTIMATED WORKING CAPITAL
AT DECEMBER 31, 1977
($000)

Line No.	Description	December 31, 1977
	(a)	(b)
1	Cash Working Capital	
2	Estimated Operating Expenses	$55,341
3	Less: Depreciation Expense	24,917
4	Expenses Requiring Working Capital	$30,424
5	Average Daily Expenses (Line 4 ÷ 153 Days)	199
6	Net Lag (Days)	15
7	Cash Working Capital (Line 5 x Line 6)	2,985
8	Materials and Supplies[1]	6,336
9	Total Working Capital	$ 9,321

1. Estimated Alyeska Supplies of $40,000 x 15.84%.

Reply of Mobil Alaska Pipeline Company to Protests to its Tariffs Over the Trans Alaska Pipeline System, June 22, 1977.

BEFORE THE INTERSTATE COMMERCE COMMISSION

REPLY OF MOBIL ALASKA PIPELINE
COMPANY TO PROTESTS TO ITS
TARIFFS I.C.C. NOS. 1 AND 2
OVER THE TRANS ALASKA PIPELINE SYSTEM

[Remaining Caption Omitted in Printing.]

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REPLY OF MOBIL ALASKA PIPELINE COMPANY TO PROTESTS TO ITS TARIFFS I.C.C. NOS. 1 AND 2 OVER THE TRANS ALASKA PIPELINE SYSTEM

Preliminary Statement

Mobil Alaska Pipeline Company ("Mobil Alaska") hereby responds to four petitions protesting tariff rules and rates for pipeline transportation through its undivided five percent interest in the Trans Alaska Pipeline System ("TAPS").* Mobil Alaska objects to consideration by the Commission of any request or proposal for the suspension of its initial TAPS rate tariff pursuant to the provisions of 49 U.S.C. § 15(7), on ground that the Interstate Commerce Commission is without authority to suspend a tariff filed in the first instance.

All four protestants request the Commission to suspend the first and only tariffs of TAPS owners. Each further requests that upon suspension, the Commission enter an order allowing respondents to refile tariffs on one days' notice at substantially lower levels to be specified by the Commission in accordance with the protestants' own suggestions pending the full investigation of TAPS tariffs which is required by the Interstate Commerce Act. 49 U.S.C. § 1 *et. seq.* (hereinafter "the Act").

* The four protests filed June 15, 1977 seek suspension of the first and only rate tariffs for transportation in TAPS filed by seven of the eight undivided interest owners of TAPS. The protests include (1) Protest/Complaint of the State of Alaska Seeking Suspension and Investigation of Initial Rates, etc. ("Alaska Protest/Complaint"); (2) Protest and Petition of the Bureau of Investigations and Enforcement For Suspension and Investigation ("Bureau's Protest"); (3) Protest and Petition For Suspension By the United States Department of Justice, etc. ("Justice Protest"); and (4) Petition and Complaint By Arctic Slope Regional Corporation For Suspension of Initial Rates, etc., as supplemented June 16, 1977 ("ASRC Petition").

The protestants implicitly urge the Commission to award damages on the basis of their bare allegations that TAPS tariffs will, upon proper investigation and hearing, eventually be found unlawful. Should protestants' prejudgments prove mistaken, any damages extracted in these circumstances cannot be recaptured by the TAPS owners. Under the Act, a carrier has no right to recoup losses where undercharges are imposed by or result from Commission action. One unfamiliar with the Act might assume that the protestants who will reap these spoils directly are acting now because they will be unable to recover damages should the TAPS tariff level eventually be determined to be higher than the Act can allow. This is not the case. Both the Act and general legal principles fully protect one who is damaged by tariffs properly determined to be too high. Persons damaged can recover overcharges or other losses with interest. Thus, the Act is barren of any basis which would justify these allegedly emergency proceedings, and the protests fail completely to supply any justification for the Commission's apparent abandonment of those regulatory procedures established by statute.

Aside from their fundamental lack of fairness, protestants' relief requests exceed the Commission's statutory power and constitutional responsibilities. The Commission's power to suspend tariffs does not extend to tariffs filed in the first instance. The plain language of section 15(7) of the Act, 49 U.S.C. § 15(7), confirmed by its legislative history, is sufficient to demonstrate that the Commission's significant power to suspend extends only to proposed *changes* in rates.

The ICC lacks the power to set the rates of a carrier unless it has first conducted a "full hearing" on the lawfulness of a challenged rate and, based on the evidence ad-

duced in such hearing, made a determination that the challenged rate is unlawful under the Act. 49 U.S.C. § 15(1).* Such findings are then subject to judicial review. A summary suspension proceeding, such as that proposed for the TAPS tariffs, in which the Commission would assert broad discretion essentially immune from effective judicial review, could never suffice to satisfy the requirements of § 15(1). Moreover, the Commission cannot use the fiction of giving the carrier-to-be the options of not operating or else acceding to a Commission-specified rate level in order to create the illusion that the suggested new rate is a carrier-made rate and not an agency-made rate. See: *Moss* v. *Civil Aeronautics Board,* 430 F.2d 891 (D.C. Cir. 1970). Even if suspension were permissible, the devastating effect of not operating converts the first choice into no choice at all. In reality, the choice which protestants would place on the TAPS owners is a choice between two unlawful alternatives. Mobil Alaska could not obtain restitution for the substantial losses resulting from either a suspension of operations for seven months or from operating under a low Commission-imposed rate for the pendency of a hearing which could take years. Adopting the fiction of the interim rate as a carrier rate, as the Bureau necessarily does for consistency in its theory of the suspension power, means that upon acquiesence in an interim rate order TAPS carriers are wholly deprived of the right to defend their rates in a full hearing. The Bureau's Protest and Petition at 12 recognizes that upon refiling an investigation would examine the *refiled* rate.

Mobil Alaska vigorously opposes any attempt by the Commission to evaluate and determine the reasonableness of the TAPS tariffs in the truncated proceedings presently

* See the Summary of Pipeline Regulatory Procedures issued by the Commission April 19, 1977.

scheduled to conclude in the oral arguments to be held on Monday, June 27, 1977. TAPS tariffs must be implemented as filed by the carriers. Any effort by the Commission to vary those tariffs as to either their stated rates or their time of effectiveness must be considered an egregious breach of the agency's statutory duty since it would result in the deprivation of the TAPS owners' most fundamental constitutional rights.

Mobil Alaska can assure the Commission of the following: *First,* that its tariff rate was calculated in accordance with the procedures followed on past pipeline tariff rate computations by other Mobil pipeline entities which have never been subject to protest or complaint; *Second,* during any investigation which may result from the protest filed against the TAPS tariffs, Mobil Alaska will demonstrate that its tariff is both lawful and reasonable; and *Third,* that the protestants' contention that an investor is entitled to no return on an investment made with borrowed money is irrational and, if adopted by the Commission, would have catastrophic impact on present and future operations by all pipelines.

ARGUMENT

I

PROTESTANTS REQUEST RELIEF WHICH THE COMMISSION IS WITHOUT AUTHORITY TO GRANT

A. THE COMMISSION IS WITHOUT AUTHORITY TO SUSPEND TAPS TARIFFS NOW ON FILE; THE SUSPENSION POWER MAY BE EXERCISED ONLY WITH RESPECT TO CHANGES IN RATES

Protestants' assumption that the suspension power conferred in § 15(7) of the Act applies to tariffs filed in the

first instance is inconsistent with the Act's regulatory scheme. The plain language of § 15(7) limits its application to rate changes, more specifically to new rates which affect pre-existing rates. The legislative history of § 15(7) confirms that limitation. Cases, particularly Supreme Court cases explaining and defining the Commission's regulatory power, have never suggested that § 15(7) could be utilized to enjoin operations of an entity seeking to commence common carrier operations under Part I of the Act. The Commission's authority to suspend a tariff in the first instance, however, has not previously been placed in issue. Consequently, neither courts construing the Act nor ICC decisions have squarely ruled on the precise question now raised by protestants' extraordinary requests.

1. The Regulatory Scheme Of Part I Is Inconsistent With The Existence Of Power To Suspend A Tariff In The First Instance

The regulatory scheme created by Part I of the Interstate Commerce Act, 49 U.S.C. §§ 1-27, ("Act"), leaves with the carriers the right, existing at common law, to initiate rates and to adopt such policy of rate making as the carrier deems wise, within the strictures of the Act. The rates, which are initially set by the carrier, are subject to limited revision by the Commission. However, ICC authority to set rates arises only after existing rates are examined in a "full hearing" and found unlawful. 49 U.S.C. § 15(1). The general purpose of this scheme is to give full play to competitive and market conditions and to permit innovative business response, with the ICC stepping in only to avoid discriminatory or anticompetitive practices or to promote transportation policy goals established by Congress. Pipe-

line carriers lack the economic insulation of franchised public utilities, which have exclusive, expanding markets in which to operate. Rather, pipelines go into business subject to existing or potential competition from other pipelines and other forms of transportation, and are subject to a full panoply of business risks.

The carrier's right to initiate rates is a predominate theme of the Act. To construe the suspension power so as to summarily revoke and reset a carrier-made rate is a drastic exercise which must rest on precise authorization in the Act. Protestants offer no such justification for the enormous power they attribute to the Commission.

The Supreme Court has consistently held that the Act has not taken from carriers the right to initiate rates and rate changes. As expressed in *Interstate Commerce Commission* v. *Louisville & Nashville R. Co.*, 227 U.S. 88 (1913):

> Under the statute the carrier retains the primary right to make rates, but if, after hearing, they are shown to be unreasonable, the Commission may set them aside and require the substitution of just for unjust charges. The Commission's right to act depends upon the existence of this fact, and if there was no evidence to show that the rates were unreasonable there was no jurisdiction to make the order. 227 U.S. at 92.

The hearing referenced in the *Louisville* decision is, of course, a formal adjudicatory hearing with full evidentiary rights to present testimony, and cross-examine witnesses. *Id.* at 93. Justice Cardozo succinctly stated in *United States* v. *Illinois Central R. Co.*, 263 U.S. 515 (1924):

> A carrier is entitled to initiate rates, and in this connection, to adopt such policy of rate making as to it seems wise. 263 U.S. at 522.

The Act's commitment to carrier-initiated rates is too well-established to give rise to any serious dispute. Other cases declaring this regulatory principle include *Aberdeen & Rockfish R. Co.* v. *SCRAP*, 422 U.S. 289, 311 (1975); *United States* v. *Chicago, Milwaukee, St. Paul & Pacific R. Co.*, 294 U.S. 499 (1935); *Arizona Grocery Co.* v. *Atchison, Topeka & S.F. R. Co.*, 284 U.S. 370 (1932).*

These cases indicate that the commitment to carrier-initiated rates is part of the intent reflected in the Act to preserve market forces. For example, in *American Sugar Refining Co.* v. *Delaware, L & W R. Co.*, 207 F. 733 (3d Cir. 1913), the court declared the importance of strict conformance to the Act:

> Especially is this true as to those provisions of the act relating to the important and vital function of ratemaking and rate changing, which aside from statutory regulation and the requirements of the common law, as to the duty of common carriers, can be exercised within the domain of that freedom of contract that is incident, under free institutions, to individual enterprise. 207 F. at 737.

In connection with a statement that carriers initiate rates to adopt their own policy of ratemaking, the Court in *United States* v. *Chicago, Milwaukee, St. Paul & Pacific R. Co., supra*, noted with approval an ICC refusal to extensively prescribe rates because "[t]he forces of competition were left to do their work."

---

* *See also, Skinner & Eddy Corp.* v. *United States*, 249 U.S. 557 (1919); *Cincinnati, New Orleans & Texas Pacific R. Co.* v. *Chesapeake & Ohio R. Co.*, 441 F.2d 483 (4th Cir. 1971); *American Sugar Refining Co.* v. *Delaware, L & W R. Co.*, 207 F. 733 (3d Cir. 1913); *Luckenbach Steamship Co.* v. *United States*, 179 F. Supp. 605 (D. Del. 1959); *Kenny* v. *United States*, 103 F. Supp. 971 (D.N.J. 1952).

The ICC's own opinions reflect the commitment to carrier-initiated rates. *See, e.g., TOFC, Freight, All Kinds, Plan IV*, 346 I.C.C. 25, 31-32 (1974); *Hanna Mining Co.* v. *Missouri Pacific R. Co.*, 322 I.C.C. 166, 171 (1968); *Carbon Black, S.W. to United States and Canada*, 298 I.C.C. 721, 726-27 (1956).

Accordingly, the rate which a carrier establishes in its lawfully filed tariffs is automatically designated as the "legal" tariff which all must pay and from which the carrier may not deviate. If the tariff is subjected to scrutiny by the Commission in a full hearing pursuant to § 15(1), and approved, the "legal" tariff becomes the "lawful" tariff. An injured party may apply for reparations for charges exacted under an unreasonable legal tariff, but no reparations may be recovered by loss incurred pursuant to a lawful tariff. *Arizona Grocery Co.* v. *Atchison, Topeka & S.F. R. Co., supra.*

Consistent with the commitment to carrier-initiated rates, the Act is generally committed to preserving or continuing transportation services by Part I carriers pending resolution of disputes over specific rates and practices. Accordingly, the Commission is not explicitly given the authority to stop the lawful operations of any Part I carrier. Protestants' request for an exercise of the suspension power to achieve this result in the present circumstance is wholly inconsistent with this purpose and intent of the Act.

The starting point, for purposes of an understanding of the regulatory scheme, is identifying at what point an entity becomes a common carrier subject to Part I of the Act.

Section 1 of the Act declares who is subject to regulation:

> (1) The provisions of this Chapter shall apply to common carriers engaged in—
>
> (a) [Railroads]

> (b) The transportation of oil or other commodity, except water and except natural or artificial gas, by pipe line, or partly by pipe line and partly by railroad or by water—
>
> [in interstate commerce]. 49 U.S.C. § 1(1).

The operative words are "engaged" in "transportation." The word "engaged" connotes a pipeline carrier *which has commenced* the actual transportation of crude or other commodity, and strongly suggests that a pipeline in its construction phase is not subject to regulation. Courts have so held.* Commencement of actual transportation operations is the statutory trigger for jurisdiction of ICC. The implication which must be drawn from § 1 is that it is the carrier-to-be which controls the point at which it becomes a common carrier subject to the Act. Operation of the suspension power on the first and only tariff of a Part I carrier is wholly inconsistent with this scheme.

---

* *Schmitt* v. *War Emergency Pipelines*, 175 F.2d 335 (8th Cir. 1949), *cert. denied*, 338 U.S. 869. Schmitt clearly viewed the actual commencement of crude oil transportation through a pipeline as the operative jurisdictional fact for purposes of § 1. Timing of commencement of ICC jurisdiction is rarely an issue. Most cases assume that actual movement of crude, *i.e.*, actual transportation operations, are necessary for definition as a common carrier subject to the Act. *See, e.g.*, The Tap Line Cases, 234 U.S. 1 (1914); *United States* v. *Mississippi Valley Barge Line Co.*, 285 F.2d 381 (8th Cir. 1960); *Walling* v. *Rockton & Rion R.R.*, 54 F. Supp. 342 (W.D.D.C.), *aff'd*, 146 F.2d 111, *cert. denied*, 324 U.S. 880 (1945).

Further support for the view that actual commencement of transportation operations is the event triggering ICC jurisdiction is found in the common law definition of a common carrier, incorporated by the Act, as one holding himself out as ready, willing and able to engage in transportation for hire. *See, e.g., Home Insurance Co.* v. *Riddell*, 252 F.2d 1 (5th Cir. 1958); *Pacific Northern Airlines* v. *Alaska Airlines*, 80 F. Supp. 592 (D. Alas. 1948); *Kelly* v. *General Electric Co.*, 110 F. Supp. 4 (E.D. Pa.), *aff'd*, 204 F.2d 692, *cert. denied*, 346 U.S. 886 (1953); *Montgomery Ward & Co.* v. *Northern Pacific Terminal Co.*, 128 F. Supp. 475, 491 (D. Ore. 1953).

The Commission is given no authority to control who will enter into the petroleum pipeline business, nor does the Act permit it to dictate when or where a pipeline may operate. It is not given power to shut down a carrier's lawful operation, either permanently, or temporarily, despite serious violations of the Act. On the contrary, its most important powers at the outset of a carrier's transportation life is to require adherence to rate filing requirements of § 6 and to institute formal investigations of rates alleged to be unlawful pursuant to § 15(1).

Section 6 of the Act governs the publishing and filing of tariffs. Section 6(1) declares that every common carrier shall file such tariffs and specifies what shall be included therein. Section 6(7) prohibits operations in the absence of such publication and filing of tariffs. The sanctions for operation without a duly filed and published tariff are civil penalties in the form of fines. § 6(10). A tariff may be rejected for filing by ICC only if it is not in the "form and manner as the Commission may prescribe by regulation", § 6(6), or if it fails to notice an effective date for the tariff, § 6(9). No authority to enjoin a carrier's operations is granted, nor can the Commission refuse to file a tariff or otherwise leave a carrier without a lawful tariff for substantive reasons, much less on a mere allegation by protestants that a rate is unlawful. The power to reject a tariff which does not comply with Commission regulations as to form is as close as the Commission can come to putting a carrier out of lawful business, yet defects in form or date are of little consequence and can be cured in a matter of hours or days. Once filed, no deviations from the filed rate are permitted. The provisions of § 6 generally evidence the commitment to carrier-initiated rates and to free operation of carriers in a competitive market.

Once a Part I carrier has commenced operations and established its initial tariff, changes in those existing tariffs are governed by § 6(3). This subsection requires that "new" tariffs, which embody changes and are proposed to replace existing tariffs, be posted and filed on thirty days' notice.

The most pertinent section of the Act, for purposes of evaluating the propriety of the relief which protestants request, is § 15 which governs, *inter alia,* the "Determination of rates." 49 U.S.C. § 15. Because of the commitment to carrier-initiated rates, § 15(1) limits the Commission to prescription of rates only by issuance of an order upon "full hearing", which includes a panoply of discovery and procedural rights, and upon a specific finding of unlawfulness under the Act.

The purpose of the full hearing rights given to carriers in § 15(1) and the power given the Commission to prescribe rates only upon findings of unlawfulness is to provide full due process protection to the Act's overall commitment to carrier-initiated rates. Even the ultimate power of ratemaking does not stop lawful transportation operations unless a carrier refuses to comply with a final Commission Order pursuant to § 15(1). But only in this special circumstance, and on substantive grounds, can the Commission take action which would leave a carrier without a lawful tariff. Carriers whose rates have been so prescribed pursuant to § 15(1) cannot escape the effects of the Commission's prescription by refiling at levels of its own choice because of the Commission's power of suspension over such rate changes. § 15(7).

The Suspension Power

The suspension power is governed by paragraph (7) of § 15. Added to the Act in 1910, it embodies an important

power auxiliary to the Commission's power to prescribe rates pursuant to § 15(1). While the Act does not permit the Commission to prescribe or establish rates until there has been a "full hearing" and a finding that carrier rates are unlawful, it does create an interlocutory step in the process of evaluating changes in carrier-made rates which is designed to avoid hardships where allegations of unlawfulness are made. Section 15(7) permits the Commission to "suspend" a proposed "new" rate for a statutorily limited period pending a full investigation. Suspension may be ordered on the Commission's own initiative or in response to petitions by shippers or others who object to the proposed rates. The 30 day notice period for filing of rate changes specified in § 6(3) is thus necessary to allow for protests to be made and to permit the Commission to make the preliminary, interlocutory decision to suspend a proposed rate change.

The decision to suspend is within the Commission's discretion so long as it is adequately supported with stated reasons.* No reasons are necessary to support denial of a suspension request. The logical effect of suspension is to leave the pre-existing rates in effect during the suspension period and preserve carrier transportation operations. Suspensions are not, therefore, to be lightly granted for the carrier can never recoup losses from such delay of increases in rates during suspension even though his proposed changes are ultimately approved as lawful. Where the new rate is not suspended but ultimately found unlawful, shippers or others injured thereby have the right to recover reparation or damages.

* *E.g., Port of New York Authority* v. *United States,* 451 F.2d 783 (2d Cir. 1971); *Oscar Mayer & Co.* v. *United States,* 268 F. Supp. 977 (W.D. Wisc. 1967).

Section 15(7) further states that the burden of proving the lawfulness of rate change is on the carrier if a suspension order has issued. On the other hand, ICC law and practice clearly establishes that the burden of proof of unlawfulness of an initial rate must be on the challengers thereto, rather than the carrier. To reconcile these two regulatory rules leads ineluctably to the conclusion that suspension orders do not apply to initial rates.

It is apparent that if there is no pre-existing tariff, a Commission suspension is not authorized. Such a suspension would either shut down or delay the carrier's operations for the statutory period, or require in effect an interim, Commission-established rate (one which the Commission indicates it will not suspend) in violation of § 15(1). This logical result of the regulatory scheme is rejected by protestants. However, protestants' illogical efforts to get around inconsistencies in their legal positions on Commission suspension power merely signal the overall deficiencies in their argument.*

The Act is clearly committed to preserving transportation services pending any dispute. This policy is evi-

* The Bureau, for example, in the interests of consistency, turns plain English into a looking-glass exercise by explaining how the word "increases" in § 15(7) should be construed to apply to the first and only tariff of a Part I carrier. (Bureau's Protest and Petition at 33-35). Similarly, when confronted with a situation in § 15(7), statutorily applicable only to changed rates, the Bureau dissembles, noting that the Commission "has not distinguished between changed and initial rates" in the relevant context. It then boldly asserts that the power necessary to get around this little problem can be implied from the Federal Power Commission's regulations. *Id.* at 11, n. 10. The Department of Justice glides around inconsistencies by addressing only the burden of proof law under § 15(7) and then wholly misstating it. (Justice Protest at 8). The State of Alaska argues in its Protest/Complaint at 18-19 that suspension of initial rates is eminently logical because the TAPS tariffs are "unlawful" apparently by-passing the requirements of § 15(1) and urging that a finding of unlawfulness can be presumed in the current summary context because Alaska says it is so.

denced first, in the suspension scheme itself; second, in the Act's grant of the right to recover damages or reparations thereby incurred to shippers and others who may be injured by rates eventually determined to be unlawful; and, third, by the absence of sanctions or authority in the Commission to effectively enjoin operations of a carrier in the absence of adjudicatory findings of violations of the Act. Considered in light of the Act's commitment to carrier-initiated rates, its placement of control with the carrier over when and where it will operate, and its commitment to preservation of transportation services pending full and fair resolution of disputes, it would be manifestly inconsistent to turn § 15(7) into a mechanism for disrupting this regulatory scheme. Section 15(7) is designed to preserve the status quo pending resolution of disputes over the lawfulness of a tariff proposed by a carrier. To turn it into the power to enjoin the legal operations of a carrier would add a startling new dimension to the existing regulatory scheme.

2. The Plain Language of § 15(7) Limits Its Applicability to Tariffs Which Replace Or Change Existing Tariffs

Mobil Alaska submits that the most direct test of whether § 15(7) applies to the first and only tariff of a Part I carrier—examination of the statutory language—is sufficient to demonstrate that protestants' requests for relief are legally unauthorized. The main thrust of the arguments of the Bureau and the State of Alaska is that § 15(7) applies to all tariffs or to tariffs in the first instance because of the statutory use of the term "new."*

* Alaska's Protest/Complaint at 17-18; Bureau's Protest and Petition at 11.

The use of the term "new," they argue, means that all tariffs are encompassed. This is plainly a misreading of the suspension provision. The term "new" tariff simply refers to a tariff whose filing replaces an "old" or pre-existing tariff. The very use of the modifier "new" to describe the tariff schedules necessarily indicates that something less than all tariffs was encompassed. Moreover, elsewhere in the Act, Congress uses the term "new" when it refers to tariffs replacing or changing pre-existing tariffs, and uses no such modifier when it refers to all tariffs.

Read in context, the use of the word "new" to describe the tariffs subject to the suspension power in § 15(7), demonstrates it is another means of describing tariffs which are changes from pre-existing tariffs of the same carrier. Section 15(7) provides:

> § 15, par. (7). [1] Whenever there shall be filed with the Commission *any schedule stating a new individual or joint rate,* fare, or charge, or any *new* individual or joint classification, or any *new* individual or joint regulation or practice *affecting any rate, fare, or charge,* the Commission shall have, and it is given, authority, either upon complaint or upon its own initiative without complaint, at once, and if it so orders without answer or other formal pleading by the interested carrier or carriers, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, fare, charge, classification, regulation, or practice; and pending such hearing and the decision thereon the Commission, upon filing with such schedule and delivering to the carrier or carriers affected thereby a statement in writing of its reasons for such suspension, may from time to time suspend the operation of such schedule

and defer the use of such rate, fare, charge, classification, regulation, or practice, but not for a longer period than seven months beyond the time when it would otherwise go into effect; and after full hearing, whether completed before or after the rate, fare, charge, classification, regulation, or practice goes into effect, the Commission may make such order with reference thereto as would be proper in a proceeding initiated after it had become effective. [2] If the proceeding has not been concluded and an order made within the period of suspension, *the proposed change of rate, fare, charge, classification, regulation, or practice shall go into effect* at the end of such period; [3] but in case of a proposed increased rate or charge for or in respect to the transportation of property, the Commission may by order require the interested carrier or carriers to keep accurate account in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts are paid, and upon completion of the hearing and decision may by further order require the interested carrier or carriers to refund, with interest, to the persons in whose behalf such amounts were paid, such portion of such increased rates or charges as by its decision shall be found not justified. [4] At any hearing involving a change in a rate, fare, charge, or classification, or in a rule, regulation, or practice, after September 18, 1940, the burden of proof shall be upon the carrier to show that the proposed changed rate, fare, charge, classification, rule, regulation, or practice is just and reasonable, and the Commission shall give to the hearing and decision of such questions preference over

all other questions pending before it and decide the same as speedily as possible. (Emphasis and brackets supplied).

It is impossible to read the first sentence's reference to "any schedule stating a new . . . rate . . . affecting any rate," Clause [1], as meaning anything but that such new rate is only new because it affects or changes another pre-existing (or "old") rate. Moreover, the second sentence plainly refers back to the very same category or tariff schedule addressed in the first sentence by the more convenient phrase "the proposed *change* of rate, fare . . ." Clause [2]. Subsequently, the statute, clause [3], specifically engages in a fine distinction between those changes which are increases and those which are not. The final sentence, addressing burden of proof, clause [4], is a straightforward reference to all the hearings instituted pursuant to § 15(7) and again refers to them as hearings "involving a *change* in a rate." It is a simple matter to read this statute as applying to rate changes, and, as more fully discussed below, the Supreme Court, other federal courts, and commentators have assumed that only changes in tariffs were involved. On the other hand it requires an unperceptive eye to construe this language as applying to all tariffs, as must be done to find this paragraph applicable to the challenged TAPS tariff of Mobil Alaska.

Section 15(7)'s companion section is § 15(1), which paragraph's reference to *all* tariffs is plain and undisputed. Where reference to all tariffs is intended Congress uses no qualifier such as the term "new" which appears in § 15(7). It plainly states "that any individual or joint rate" is subject to paragraph (1).

A similar statutory pairing is found in paragraphs (1) and (3) of § 6 which governs tariff filing. Paragraph (1) of § 6 which requires all carriers to file and publish tariffs, uses the words "all" rates of "every" carrier. Section 6(3) which plainly governs changes, like § 15(7), also uses the term "new" and, as in § 15(7), uses it in a context which equates it with changed tariffs. Section 6(3) provides in pertinent part:

> *Change in rates, fares, etc.: notice required; simplification of schedules*
>
> (3) No *change* shall be made in the rates, fares, and charges or joint rates, fares, and charges which have been filed and published by any common carrier in compliance with the requirements of this section, except after thirty days' notice to the Commission and to the public published as aforesaid, which shall plainly state the *changes* proposed to be made in the schedule then in force and the time when the *changed* rates, fares, or charges will go into effect; *and the proposed changes shall be shown by printing new schedules*, or shall be plainly indicated upon the schedules in force at the time and kept open to public inspection: . . . 49 U.S.C. § (3) (Emphasis supplied)

It requires no mystical talents to discern that the suspension power of § 15(7) was conferred only with respect to tariff changes; that the power was never designed to apply to tariffs in the first instance where no pre-existing carrier-made tariff is on file to permit continued transportation services. In his treatise on the Commission, Professor Sharfman discusses the suspension power as a power affecting changes and uses the term "new" to refer

to the tariffs which incorporate these changes. He states that through the suspension power

> the public was accorded substantially the same degree of protection against the imposition of burdensome and inequitable *new rates* which the railroads enjoyed against the condemnation of *existing rates.* [Pending adjudication of existing rates] . . . *the old rates remained in effect until the final disposition of the proceeding . . . In like manner,* under the authority of the Commission to suspend proposed *changes* in rates, the railroads might be shorn of the power to disturb existing rates except after investigation of the *new* schedules by the Commission; and since the reasonableness of the *charges already in effect* would not necessarily have been adjudicated . . . the burden was cast upon the railroads to justify the advanced rates proposed by them.*

Similarly, the Supreme Court in *United States* v. *SCRAP*, 412 U.S. 669, 697 (1973), equated "new" with "increased."

> [W]e stressed in Arrow that § 15(7) represents a careful accommodation of the various interests involved. The suspension period was limited as to time to prevent excessive harm to the carriers, for the revenues lost during that period could not be recouped from the shippers. On the other hand, Congress was aware that if the Commission did not act within the suspension period then the *new* rates

* 1 Sharfman, INTERSTATE COMMERCE COMMISSION 59-60 (1931). (Emphasis supplied). (See also Spritzer, Uses of the Summary Power to Suspend Rates, 120 U. Pa. L.R. 39 (1971); Goodman, The History and Scope of Federal Power to Delay Changes in Transportation Rates, 19 I.C.C. Prac. J., 245.

> would automatically go into effect and the shippers would have to pay *increased* rates that might eventually be found unlawful. To mitigate this loss [the special accounting procedures were included].* (Emphasis added)

While such analysis would seem sufficient to dispose of the question, it is necessary to go further and explore the legislative history of § 15(7) since the Commission, by issuing the order pursuant to which this reply is submitted, evidences its preliminary view that it can suspend Mobil Alaska's original TAPS tariffs. The record of Congressional intent conclusively demonstrates that § 15(7) applies solely to changes in pre-existing tariffs.

3. The Legislative History to § 15(7) Confirms That It Applies Only To Changes In Pre-existing Tariffs

Section 15(7), conferring the significant power to suspend, was added to the Interstate Commerce Act in 1910 by the Mann-Elkins Act, Pub. L. No. 218, 36 Stat. L. 539, ch. 309, June 18, 1910. The 1910 legislation permitted suspension for up to 120 days from the effective date of the tariff, with power to extend the suspension period an additional six months. Section 15(7) has been modified since 1910, most particularly, the period of suspension has been reduced and then enlarged to the existing seven-month

* Note the concern that a carrier subject to a suspension order would be unable to recoup its lost revenues from shippers if its rates were ultimately vindicated following full adjudication. Obviously such concern presumes that transportation for shippers will continue during the suspension period. The same opinion declares that the Commission may prescribe rates only pursuant to § 15(1), precluding the possibility that a quick prescription of rates could mitigate the drastic effect of suspension of a first and only tariff.

maximum,* but the language relevant to determining whether it applies to changes or to all rates has remained literally unchanged. Examination of the legislative history of the Mann-Elkins Act unequivocally demonstrates that § 15(7) was enacted in order to give the Commission some power to deal with the problem of spiraling rate increases and that it was drafted to apply only to proposed changes in existing rates. This history conclusively shows that § 15(7) was not intended to apply to a carrier which had no pre-existing rate on file. As summarized in *Sharfman, supra*:

> The rate-suspension power as originally conferred upon the Commission in 1910, was a notable extension of its authority. It made possible the investigation of changes in rates, both as to their reasonableness *per se* and as to the equitableness of their adjustment, prior to actual enforcement of the new tariffs. Without infringing on the ultimate rights of the carriers to initiate rates and charges, this power enabled the Commission to enter upon the regulating process at an earlier stage than in the usual proceedings upon complaint, and thereby to prevent, at the threshhold, rate changes likely to violate the basic standards of the Act to Regulate Commerce. . . . ***The old rates remained in effect till the completion of the Commission's investigation.*** *Id.* at 201-2 (Footnotes omitted.)

* The Transportation Act of 1920, 41 Stat. 487, ch. 91, tit. IV, § 418 (1920), reduced the maximum of ten months to five months. In 1927 the Commission successfully sought extension of the period as it was unable generally to conclude full hearings within five months. The Act was then amended to its present format to allow a seven month suspension. 49 U.S.C. § 15(7) (1970). The special accounting procedures for increases were added in 1920.

The legislation was proposed in response to widespread concern over dramatic ever-increasing railroad rates. President Taft drafted legislation to respond to this concern and sent a Presidential Message to Congress explaining his and others' proposals to cure the problem. The concern was solely with the Commission's inability to adequately respond to changes in existing tariffs:

> Under the existing law the commission may not investigate an increase in rates until after it shall have become effective; and although one or more carriers may file with the commission a proposed increase in rates or change in classifications, or other alteration of the existing rates or classifications, to become effective at the expiration of thirty days from such filing, no proceeding can be taken to investigate the reasonableness of such proposed change until after it becomes operative. . . . It has, therefore, been suggested that the commission should be empowered, whenever a proposed increase in rates is filed, at once to enter upon an investigation of the reasonableness of the increase and to make an order postponing the effective date of such increase until after such investigation shall be completed. (41 Cong. Rec. 462, Jan. 10, 1910).

The existing reparations rights of shippers were deemed inadequate to counter the onslaught of railroad rate increases, and it was felt that the Commission, which at that time was much smaller than now, could not effectively use its adjudicatory powers to address all increases after they took effect. President Taft endorsed the solution which became § 15(7):

> I therefore recommend that the Interstate Commerce Commission be empowered *whenever any proposed increase of rates is filed*, at once, either on complaint or of its own motion, to enter upon an investigation into the reasonableness of such *change*, and that it be further empowered, in its discretion, to postpone the effective date of such proposed *increase* for a period not exceeding sixty days beyond the date when such rate would take effect. If within this time it shall determine that such *increase* is unreasonable, it may then, by its order, either forbid the *increase* at all or fix the maximum beyond which it shall not be made. If, on the other hand, at the expiration of this time, the commission shall not have completed its investigation, then the rate shall take effect precisely as it would under the existing law, and the commission may continue its investigation with such results as might be realized under the law as it now stands. *Id.*•

This recommendation was adopted, although a longer suspension period was enacted. Indeed, the basic concept—the power to suspend rate changes pending full investigation—was scarcely disputed by Congress, while the real controversy was over the maximum length of the suspension period.•• The sixty day period drafted originally and recommended by the President was extended to 120 days, primarily on account of testimony by the Commission.••• An extension beyond 120 days for up to an additional six months was added in response to pressure from radical elements in Congress who sought to make all new rates

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• Emphasis supplied. Emphasis in remainder of this section is supplied unless otherwise indicated.

•• *See, e.g.*, 45 Cong. Rec. 6409, 6500-01, 6510-11, 6900-01.

••• 45 Cong. Rec. 6791, May 24, 1910; Sen. Report No. 355 at 9.

dependent upon Commission approval. While direct legislation to this effect was not likely to pass, they urged that the period of suspension be allowed to extend until completion of the formal rate investigation.* While debates over § 15(7) concerned the length of the suspension period, both sides of the debate repeatedly indicated their understanding that the proposed amendment would apply only to changes in rates. The report of the Senate Committee on Interstate Commerce, discussing the bill which emerged from committee with the present language of § 15(7) describing its applicability, addressed the proposed § 15(7) under the heading "INVESTIGATION BY THE COMMISSION OF PROPOSED INCREASE IN RATES," Sen. Rep. No. 355, 61st Cong., 2d Sess. at 8. The report described the problem and then set forth the debate:

> To meet this situation it has been contended by some that the commission should be empowered to postpone the date when a proposed *increase* in rates should become effective until it should complete an investigation into the reasonableness of the proposed *increase;* while on the other hand it is urged on behalf of the railroad companies that such action would bear unjustly upon the carriers, as, if at the termination of such investigation it should be found that the proposed increase was reasonable and proper, *the carrier would have lost the entire benefit of the increase in rates* during the period of investigation, without any means of reparation. (Sen. Rep. No. 355 at 8-9).

The majority of the Interstate Commerce Committee resolved this dilemma by adopting the suspension power but

* See Sen. Rep. No. 355, Part 2, Views of the Minority, March 7, 1910; 1 Sharfman, *supra*, at 59 n. 61.

limiting the suspension period to minimize harm to the carrier whose proposed rates are ultimately vindicated.

> A majority of the committee is of opinion that the Interstate Commerce Commission should be authorized to commence the investigation of a proposed increase in rate, or change in classification, as soon as it is filed with the commission, and that at any time before the rate or classification would become effective, the commission should, in its discretion, be empowered, by order stating its reasons therefor, to postpone the effective date of such increase or classification for a reasonable period to enable it to investigate the proposed action.
>
> The bill fixes this reasonable period at sixty days, thus giving the commission ninety days in all within which to complete its investigation—a length of time which can not possibly work any serious hardship to the railroad companies, and which, on the other hand, will afford the commission opportunity with due diligence to complete or, at all events, to make substantial headway in any such investigation. (*Id.* at 9)

The concern with unjust denial of revenues to carriers whose proposed rates are ultimately approved following suspension was clearly with loss of incremental *increase* in revenues. Nowhere in the legislative history is there even contemplation of a suspension power that could deny *all* revenue during the suspension period, the necessary effect of § 15(7)'s application to tariffs filed in the first instance.

The minority report understood the new provision to apply solely to changes, but expressed little sympathy for carriers who would lose the benefit of increased revenues during suspension:

Protest Reply of Mobil Alaska.

The second paragraph of the section [Sec. 9 of S. 6737, now § 15(7)] is entirely new to the law. It confers upon the commission the *power to suspend changes in rates* pending a hearing upon the propriety of the *change,* for not to exceed sixty days beyond the time when the proposed *changes* would otherwise go into effect. We fear that the limitation will nullify the object sought to be accomplished, because it is admitted that it would be impossible for the commission to make the proper investigation of the larger number of the *changes* that will be made within the time so fixed. It is so vital to the business of the country that there shall be a reasonable supervision exercised by the commission before *changes* in rates shall go into effect, that we earnestly recommend an amendment which will permit the suspension to continue until the hearing is concluded. *Id.*, Part II at 9.

In describing the bill as reported from the Committee on Interstate Commerce,* with an extension to 120 days of the suspension period, Senator Cummins stated:

* The provision as reported from the Senate Committee provided: Whenever there shall be filed with the commission any schedule stating a new individual or joint rate, fare, or charge, or any new individual or joint, classification, or any new individual or joint regulation or practice affecting any rate, fare, or charge, the commission shall have, and it is hereby given, authority, either upon complaint or upon its own initiative without complaint, or upon its own initiative without complaint, at once, and if it so orders, without answer or other formal pleading by the interested carrier or carriers, but upon reasonable notice, to enter upon a hearing concerning the propriety of such rate, fare, charge, classification, regulation, or practice; and pending such hearing and the decision thereon the commission, upon filing with such schedule and delivering to the carrier or carriers affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate,

Protest Reply of Mobil Alaska.

> I first take the provision as it is reported by the committee. May I remind Senators just what it is? It provides that after the passage of this bill, *when changes in rates are made or sought to be made* by railway companies, the Interstate Commerce Commission may, if it is moved to do so, either upon complaint or upon its own initiative, suspend such of the rates as it desires to suspend for a period of not more than one hundred and twenty days. (45 Cong. Rec. 6777, May 24, 1910).

By way of example he clarified its application to tariff changes, that is, to new tariffs which take the place of preexisting or old tariffs:

> If you will imagine with me a schedule going before the Interstate Commerce Commission, I think we can soon reach exactly the result of this bill if it becomes a law. A schedule is filed, presenting *changes* in rates. There is no discrimination now in the bill as to whether the rates are increased or decreased, or whether they remain as they were. The commission takes up that schedule, and then it must determine whether the rates found in it, or any part of them, are to be suspended or not. *Id.*

Sen. Cummins had introduced an amendment to the provision reported out which would supersede in part the 120

fare, charge, classification, regulation, or practice, but not for a longer period than sixty days beyond the time when such rate, fare, charge, classification, regulation, or practice would otherwise go into effect. [As reported in 45 Cong. Rec. 6500 (May 19, 1910)].

The provision as enacted into law in 1910 substituted "one hundred and twenty" for "sixty." 36 Stat. L. 552, ch. 309, 61st Cong., 2d Sess. (1910).

day language by allowing the suspension period to extend until conclusion of any investigation in the case of new rates which were *increases.** There is no doubt that the provision's use of the term "new" rate was intended to apply to changes, *i.e.,* tariffs replacing old rates.

> Mr. Cummins. There is a general provision in the bill that all *changes* in rates may be suspended for a period of one hundred and twenty days to enable the commission to examine the *new* rates so filed, and that applies to reductions, to the maintenance of the level of rates theretofore existing, and to increases of rates as well. *Id.* at 6778.

Contrary to the Bureau of Investigations and Enforcement's contention and Alaska's similar contention, the phrase "any schedule stating a new . . . rate" was not in-

* The Cummins amendment contained the same relevant language as the 1910 version of § 15(7) which passed and which is still in effect. It would have added the following proviso to the approved Committee provision:

> Provided, however, That whenever there shall be filed with the commission any schedule stating a new individual or joint rate, fare, or charge which is an increase over the then existing rate, fare, or charge, or any new individual or joint classification which effects such increase, the operation of any such increase shall be suspended and the use of any such increased rate, fare, charge, or any new individual or joint classification which effects such increase, the operation of any such increase shall be suspended and the use of any such increased rate, fare, charge, or classification shall be deferred until after full hearing and shall take effect only after the commission has found and declared the same to be just and reasonable. . . . 45 Cong. Rec. at 6499.

Cummins effort was unsuccessful. The proviso actually added allowed an extension of the suspension period for all new rates for up to six months if a full hearing was not concluded at the end of the initial 120 day suspension. 36 Stat. L. 552. Ch. 309, 61st Cong., 2d Sess. (1910).

tended to encompass all rates. Rather the term "new" rate was intended to refer to one replacing an 'old' rate. The repeated statements that the provision applies to changes are not the only evidence that the language itself had been drafted to exclude initial rates. The following uses of the term "new" are instructive.

> [By Sen. Hayburn, referring to Sen. Cummins amendment] . . . It does not disturb the provisions of the section prior to that unless it should be inconsistent with them. I think the provisions contained in the bill is stronger and more effective than that contained in the amendment. Let us see briefly. In the bill it is provided that—
>
> "Whenever there shall be filed with the commission any schedule stating a new individual or joint rate — —"
>
> *That may be higher or lower — —*
> "fare, or charge, or any new individual or joint classification — —"
>
> *That may be higher or lower — —*
> (45 Cong. Rec. 6792-3)

In a statement exploring whether under the Cummins version the new rate automatically went into effect at the end of the six month suspension extension, Sen. Dolliver remarked:

> But the Senator from Arkansas says "No; if they are not decided, if the six months pass away and no decision is rendered, then the *new rate increasing the old* goes into effect . . . .
>
> *If it means that the old rate remains at the end of six months awaiting the decision of the commission*

> *upon the new rate, I have no objection to it.* If it means that a failure to decide inside the six months puts into effect the new rate, increasing the old rate, I doubt very much whether there is any wisdom in it . . . . 45 Cong. Rec. at 6792.

Senator Dolliver was quickly assured that the emphasized sentence reflected the actual impact of the Cummins version which he favored, and did not mean that the old rate ceased upon the end of the suspension period. *Id.* Under either version, all assumed that the operative language "any schedule stating that a new . . . rate" necessarily meant that there was an old or pre-existing rate which would remain in effect during the suspension period, thus preserving transportation services. This understanding is also shown in the following exchange:

> Mr. Dolliver. Suppose they fail within six months to so proceed with that hearing as to enable the commission to render a decision upon it, in what shape would the failure of the commission to decide leave the proposal of the railroad to increase the schedule of rates?
>
> Mr. Martin. [The Cummins amendment] would leave the old rate in existence, and the application to increase it would be denied, as it ought to be denied, until the commission is satisfied that the increase should be made.
>
> Mr. Rayner. I have not any doubt about it, but still *why not put in a provision that the old rate shall remain until the Interstate Commerce Commission is affirmatively satisfied that the increase is just?* 45 Cong. Rec. at 6788.

This is but a sample of numerous indications that the operative language of § 15(7) was understood by its drafters to apply only when the carrier subject to a suspension order had a preexisting tariff on file which could remain in effect during the period of suspension. The gist of § 15(7) is to preserve the status quo, it preserves transportation services pending resolution of disputes. Most importantly it does so in a way which avoids reliance on any improperly prescribed Commission-made rate. Rather, by the fallback onto the pre-existing rate, the carrier's right to initiate rates is preserved because a carrier-made rate continues in effect until and unless a proper Commission-finding of unlawfulness has been rendered. Even Sen. Cummins, who would happily have permitted suspensions of tariff increases for years and years pending conclusion of formal hearings, appreciated the importance of the carrier's right to initiate its rate and charge it until such time as a proper finding of unlawfulness had been rendered. He observed:

> I am always rather sympathetic with the underdog; and inasmuch as the railway companies have fixed their present rates, it is not to be assumed that any great hardship will be done if, until the increases receive the approval of the commission, *they are required to be content with the rates that they themselves have established.* 45 Cong. Rec. 6503, May 19, 1910.

He also stated:

> But, as I was about to say when interrupted by the Senator from Idaho, this bill as it is may, and probably will, result in some of the rates being examined before they take effect. The exception which I propose says nothing more than that increases in rates

> shall be examined before they take effect. *It seems to me it is only right and fair that the railway companies, having established the rates, and they being presumably, therefore, reasonable from the railways' standpoint, ought not to be permitted to increase them until the Government has said the change is fair and right.* *Id.* at 6504.

Further evidence of the understanding that transportation services at pre-existing rates would continue during a suspension exists:

> Mr. Jones . . . If the shipper has to pay an unreasonable rate, he has his remedy. It may not be as effective as we would like, but he can recover his overpayments. But suppose that the railroad desires to put into effect a rate which is an increase and which is finally determined to be a reasonable rate, but the decision upon it is delayed for six months or a year or two years; what remedy has the railroad company [subject to a suspension order during that time] for being deprived of a just compensation *for the service it has rendered during that time?* Has it any?
>
> Mr. Cummins. It has none.
>
> Mr. Jones. That was my impression.
>
> Mr. Cummins. And it ought not to have. We can not administer perfect justice in a country like ours, or in any other of which I know. We must approach justice as nearly as possible.
>
> Mr. Jones. That is true, and that is one reason which impresses me somewhat with the importance

> of limiting the time in which these rates may be suspended. 45 Cong. Rec. 6782. (Emphasis added)

In an earlier debate, Sen. Cummins stated that if, following suspension, "the commission did not decide upon the increased rate, the railway company *would continue to charge its present rate.*" 45 Cong. Rec. 6503, May 19, 1910 (Emphasis added).

Mobil Alaska has earlier demonstrated that both the scheme of the Act and the plain language of § 15(7) preclude its application to the present circumstance of a carrier filing its first and only tariff. It has now conclusively shown that Congress specifically drafted § 15(7) so as to preclude application to a carrier in Mobil Alaska's present position.

At the time that § 15(7) was first enacted, the Commission itself evidenced its understanding that the suspension power was conferred in order to respond to tariff changes. The Commission testified in favor of the proposed legislation in 1910. Chairman Knapp, urging that the suspension period be extended beyond the 60 days of the original Senate bill, stated:

> The next point relates to the suspending of rate *changes*, a subject which is dealt with, beginning on page 17 and line 12. We are of the opinion that the commission should have the power to suspend rate *changes* for a longer period than sixty days, in order that there may be reasonable time for investigation; and especially in view of the fact that no final order after hearing can take effect under the present law until at least thirty days after it is made. 41 Cong. Rec. 6791, May 24, 1910 quoting from Hearings before the Senate Committee on Interstate Commission at 204.

In its 1910 Annual Report the Commission summarized its "authority to suspend proposed *advances* in rates pending investigation of their propriety" as "perhaps the most far-reaching and fundamentally important power conferred upon it." *Annual Report*, 1910, p. 5.

The Commission, upon passage of the Mann-Elkins Act in 1910, understood that it applied only to changes, or more particularly to new rates which replace old rates, regardless of whether particular rates are actually changed. In the 67 years since it was granted the important power to suspend, the Commission has never used it effectively to enjoin the entire operations of a Part I carrier, as it has now suggested it can do in instituting the present suspension proceeding.

4. Case Discussion of the Suspension Power Is Consistent With Its Applicability Only To Changes in Pre-existing Tariffs

The issue squarely raised in this reply, whether the suspension power of § 15(7) can be lawfully exercised to suspend the original and only tariff of a Part I carrier (or such carrier's newly constructed pipeline), has never been presented to a federal court. However, court discussions of the suspension power evidence an understanding or assumption that § 15(7) refers only to tariff changes. The ICC has confronted a circumstance such as that at issue here but one time, according to reported decisions, and, significantly, it did not attempt to exercise the suspension power.

Commission decisions over the past 67 years have occasionally suggested, or even asserted, the existence of authority to suspend initial rates. However these cases are inapposite.

In many cases, the decisionmaker uses the term "initial" rate misleadingly. That is, while the decision states that an "initial" rate was suspended, in fact the carrier had pre-existing rates on file which were affected by the so-called "initial" rate, thus clearly and properly coming within the terms of § 15(7). For example, in *Cotton From New Orleans*, 49 I.C.C. 751 (1918), which is cited in Alaska's Protest/Complaint at 16, the Commission suspended an "initial" rate for shipping cotton by water vessel from New Orleans to New York. The company whose rates were suspended was already servicing this route by way of tariffs covering routes originating before New Orleans to New York, or originating in New Orleans for destinations beyond New York. The Commission had ordered the company to file a separate tariff for New Orleans to New York, a new tariff which clearly affected the pre-existing tariffs on file, within the meaning of § 15(7). The water carrier challenged the Commission's authority to suspend the so-called "initial" tariff, arguing that § 15(7) applied only to *increased* rates. The Commission properly rejected this limited view of § 15(7) and held that the rates at issue were "new" rates within the meaning of § 15(7):

The Commission (Div. 2) stated:

> It is argued that the Commission's suspension power is limited to an increase in rates previously on file and subject to its jurisdiction and, therefore, that it had no authority to suspend the port-to-port rates under investigation. This contention is without merit. Under section 15, paragraph 1, of the act to regulate commerce, the Commission, on its own initiative, whenever it is of the opinion that any rates demanded, charged, or collected are in any way unlawful, may enter upon an investigation, hold full

> hearings, and determine and prescribe just and reasonable rates. Where *new* rates are filed, the Commission, under section 15, paragraph 2, is authorized by similar means to determine the propriety of them, and, pending such determination, to suspend the operation of the schedules stating such new rates. The local rates under suspension in this proceeding applicable to port-to-port traffic were new rates. . . . 49 I.C.C. at 752.

Later in the decision the Commission refers to the "new" or proposed rate as a "proposed change" in the rates on compressed cotton. *Id.* at 753. The Commission went on to determine whether the "new" rate at issue was an "initial" rate for purposes of burden of proof, and determined that in this context the proposed suspended rates "are initial rates, not increased rates." *Id.*

Thus, in regulatory jargon an initial rate may be a changed rate, certainly the term "initial" rate cannot be equated with the term "new" rate used in § 15(7). In fact § 15(7) nowhere refers to "initial" rates. In view of this sometimes confusing and often ambiguous use of the term "initial rate," it is clearly insufficient for protestants, including the Bureau, to cite "initial rate" cases without analysis in support of the proposition that a first and only tariff of a pipeline carrier is properly subject to § 15(7). Most "initial" rate cases involve burden of proof rather than decisions addressing the suspension power.

As an example, Alaska's Protest/Complaint at 18-19 cites *Rail-Water, Grain In Bulk, Missouri, Illinois and Indiana to Buffalo*, 321 I.C.C. 564 (1963), where the Commission had suspended proposed joint rail-water rates for grain. While, as Alaska points out, "the Commission specifically referred to its suspension power with respect to 'initial'

rates at page 566" (Alaska Protest/Complaint at 18), that reference cannot alter the fact that both the railroad and the steamship company, whose joint "initial" tariffs were suspended, had on file at the Commission tariffs covering their respective segments of the proposed "new" joint rail-water rates. As in the *Cotton from New Orleans* decision, *supra*, the steamship company was found to have filed an "initial" rate for purposes of burden of proof, but not for purposes of whether the relevant tariff was properly subject to the suspension power.

In *Bituminous Coal via Motor-Rail from Lynnville, Indiana, to Chicago, Illinois*, 313 I.C.C. 573 (1961), another Commission decision relied upon by the State of Alaska, the issue was also who should have the burden of proof on a proposed motor-rail rate for bituminous coal from Lynnville, Indiana to Chicago, Illinois. Since the decision was concerned with the burden of proof matters it does not clearly state the extent to which pre-existing tariffs were in existence. In any event, the authority of the ICC to suspend the relevant rates was not in issue.

The Bureau cites *Animal Food, Midwest to California, Idaho, and Utah*, 332 I.C.C. 87 (1967) in support of the proposition that the Commission can suspend initial rates. The issue is not whether the Commission can suspend "initial" rates but whether it can suspend the first and only tariff of a carrier. In the *Animal Food* case, the Commission, Div. 2, states:

> In its report the board found that both initial and changed rates were involved, with the changed rates generally reflecting increases. 332 I.C.C. at 88.

The case involves changed rates. In fact, it later refers to the rates under consideration collectively as "the proposed

changed rates." *Id.* at 89. Moreover, like all the cases relied upon by protestants, no challenge to the Commission's authority to suspend was made so no discussion of that power is set forth. Each of the remaining cases cited by the Bureau is inapposite on the same bases as the *Animal Food* decision, *supra*.•

Commission decisions are not always subject to the pitfalls exposed above. In *Coal Rates from Oak Hills, Colo.*, 30 I.C.C. 505 (1914), the Commission evidences an understanding of the term "new" rates as applying to rates affecting pre-existing rates of the same carrier:

> Clearly when the proposed rates involve increases and decreases they are new rates. . . . 30 I.C.C. at 508.

Protestants' assertions notwithstanding, the Commission has confronted the decision whether to suspend a first and only tariff of a Part I carrier in only one reported decision, *In Re Wharfage Charges of the Galveston Wharf Co.*, 23 I.C.C. 535 (1912). There the Commission did not suspend, stating:

> [The tariff in issue] was the first and only tariff of the Galveston Wharf Company on file here, and an order suspending its operation would have left the wharf company without any lawful rates and would therefore have obliged it either to cease its operations or to handle the traffic of the port in violation of the act. We therefore allowed the tariff to go into effect. . . . 23 I.C.C. at 537.

• The cases include Foodstuffs and Agricultural Commodities, California and Arizona to West and South, 329 I.C.C. 321 (1966); Animal Feed from Mississippi and Tennessee to Midwest and Southwest, 316 I.C.C. 94 (1962); Clay from Greybill, Wyoming, to Points in the Middle West, 314 I.C.C. 705 (1961); Machinery from Salt Lake City-International Transport, Inc., 304 I.C.C. 286 (1958). See Bureau Protest and Petition at 12.

While this decision is not cast in terms of whether the Commission had power to suspend such a "first and only" rate, it is a more compelling precedent than any of the decisions cited by protestants because it is the only decision which addresses suspension of a tariff that is clearly *not* a "new . . . rate . . . affecting any rate" under § 15(7). Moreover the *Galveston Wharf* case plainly distinguishes the "first and only tariff" situation quoted above, from subsequently filed tariffs by the Galveston Wharf Company. The first subsequent tariff is referred to as the "new tariff." This "new tariff," which had been filed less than thirty days after the first one, was promptly suspended even though the level of rates it contained scarcely varied from those in the first tariff. Noting that despite its decision not to suspend the first tariff the Commission had instituted an investigation, the Commission continued:

> On April 26 the wharf company filed its tariff No. 2, by the terms of which it proposed to substitute class and commodity rates for the switching charge of $1.75 a car provided in its first tariff. The new tariff by its terms was to become effective on June 9, 1911, but its operation was suspended by our order pending this investigation. *Id.*

The obvious inference from all this is that the Commission would have suspended the first tariff but for the limitation of its suspension power to "new . . . rate(s) . . . affecting any rate. . . ." Mobil Alaska submits that it does not require mere inference to conclude that the Commission's suspension power, granted in § 15(7), does not extend to the "first and only" tariffs of TAPS owners. As in the *Galveston Wharf* case, the Commission can only respond to protests of a first and only tariff by instituting an investigation pursuant to § 15(1).

Decisions by federal courts have not addressed the precise question placed in issue by TAPS protestants. Court discussions of the suspension power simply assume its limitation to tariff changes or evidence an understanding that its application is so confined. For example in *Aberdeen & Rockfish R. Co.* v. *SCRAP,* 422 U.S. 289, 296 (1975) ("SCRAP II"), the Supreme Court, reviewing the facts, observes that "ICC declined to exercise its power to suspend proposed rate increases under . . . § 15(7)." 422 U.S. at 296. It later states, that § 15(7) "lodges exclusive power to suspend rate *increases* pending final determination of their unlawfulness." *Id.* at 298. The Court then observes:

> Under the Interstate Commerce Act, the initiative in setting rates remains with the railroads. See SCRAP I. . . . The ICC has the power, after exercise of this initiative by the railroads, and after investigation, either upon its own initiative or upon complaint by an interested party, to declare a rate unlawful if it finds that the rate is unjust, unreasonable, preferential, discriminatory, or otherwise, in violation of the Act. 49 U.S.C. §§ 13 and 15. The ICC, and only the ICC, SCRAP I, *supra,* also *has the power to suspend a new rate for up to seven months pending its determination of unlawfulness.* 49 U.S.C. §15(7). *Id.* at 311 (Emphasis added).

In a footnote to the emphasized statement, the Court demonstrates its understanding that the term "new" rate generally refers to rate increases.

> Failure to suspend does not always do irreparable harm to shippers who pay the increased rates. . . Shippers can always obtain a refund . . . *Id.* at 311, n.13.

In SCRAP I, quoted *ante* at 20-21, it was similarly shown that the Court identifies the term "new" rate with the problem of increased rates suspected to be unjustified. In the first line of that opinion the Court further demonstrates its understanding that suspension applies to changes:

> Under the Interstate Commerce Act, the initiative for rate increases remains with the railroads. But in the absence of special permission from the Interstate Commerce Commission, a railroad seeking an increase must provide at least 30 days' notice to the Commission and the public before putting the new rate into effect. 49 U.S.C. § 6(3). During that 30-day period, the Commission may suspend the operation of the proposed rate.· 412 U.S. at 672.

Quoting *Arrow Transportation Co.* v. *Southern R. Co.,* 372 U.S. 658 (1963), the Court in another instance discussed the suspension power as applicable to changes:

> The Interstate Commerce Commission has the power to suspend proposed rate changes for seven months, while it proceeds to consider the reasonableness of the proposal. "If the proceeding has not been concluded and an order made within the period of suspension, the proposed change of rate . . . shall go into effect at the end of such period." 49 U.S.C. § 15(7). *Atchison Topeka & Santa Fe R. Co.* v. *The Wichita Board of Trade,* 412 U.S. 800, 820 (1973).

It further observed that:

> [i]n giving the Interstate Commerce Commission power to suspend proposed rate increases, Congress allocated the benefit and harm of a suspension. For a period of up to seven months, the carriers may

> not collect the increases if the Commission suspends them. The income that they might have gained is lost to them forever. Congress did provide protection to shippers for the period after the rate goes into effect. *Id.* at 823.

Protestants' attempt to allocate the benefit and harm of suspension with regard to TAPS tariffs is in dramatic contrast to the above remarks. The Supreme Court, like Congress, is clearly concerned with the harm that denial of the proposed incremental *increases* could work on a carrier subject to a suspension order, evidencing the presumption that transportation services will continue via a pre-existing tariff during a suspension. Protestants, on the other hand, urge an interpretation of the Act that would deprive carriers of all revenues during a suspension period. Cases and commentators consistently view the Act as limiting suspension to changed or, more accurately, "new" rates.* No court authority is available to support protestants' illogical and unjust view of the purpose and effect of § 15 (7). To achieve their purpose in permanently depriving TAPS owners of millions of dollars in revenues without trial or even semblance of due process, protestants are willing to offer an interpretation of the Act that is out of harmony with its overall scheme and sharply at odds with the plain language and undisputed purpose of the suspension provision in § 15(7).

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* See also, I.C.C. *v.* Inland Waterways Corp., 319 U.S. 671 (1943); Manufacturers R. Co. *v.* United States, 246 U.S. 457, 478-9 (1918), Amarillo-Borger Express *v.* United States, 138 F. Supp. 411, 420, fn. 14 (N.D. Tex. 1956); vacated as moot, 352 U.S. 1028. See, Spritzer, Uses of the Summary Power to Suspend Rates: An Examination of Regulatory Agency Practices, 120 U.Pa.L.R. 39, 44-5 (1971); Goodman, The History and Scope of Federal Power to Delay Changes in Transportation Rates, 19 I.C.C. Prac. J. 245 (1959).

B. The Commission is Without Authority to Prescribe Interim Rates

While protestants, to achieve their desired end, must take the position that suspension of a first and only tariff is authorized by § 15(7), they in effect concede that such a solution by itself is unthinkable. In an attempt to remove themselves from the horns of this dilemma, they propose further unlawful exercises of ICC authority.

Suspension in the circumstance presented here is an all-or-nothing proposition. To apply suspension and otherwise remain within the bounds of the Act casts the decision to suspend into a decision whether to allow the pipeline to commence lawful transportation operations. Protestants clearly do not wish to stop the Trans-Alaska Pipeline from moving crude oil. Alaska and the ASRC have enormous financial stake in the pipeline's operation. Thus their interests would be hurt by any delay in TAPS operations. The remaining protestants have no public or proprietary interest in delaying TAPS carriers' operations. Rather they recognize that such effect would be inconsistent with the National Transportation Policy and plainly contrary to the Congressional imperatives of the Trans-Alaska Pipeline Authorization Act, 43 U.S.C. § 1651 *et seq.*, Pub. L. 93-153, Nov. 16, 1973, 87 Stat. § 584.

Protestants do not advocate stopping the pipeline. On the contrary, they assume that this simply must not be done. The Bureau, for example, states that suspension must be ordered because TAPS tariffs are unreasonable and then goes on to say: "However, some rates must be filed to permit the pipeline to operate pending the investigation," therefore the Commission must set rates "in order to allow transportation to commence." (Bureau Protest and Petition at 11.) It is only by this skewered thinking that the

Bureau can advance agency prescription of TAPS rates as a solution to the dilemma of the all-or-nothing suspension power. Mobil Alaska submits that the Bureau has it backwards; it is precisely because of the need to preserve transportation services that suspension cannot be construed to apply to TAPS owners' first and only tariffs. It is not the Commission's decision to determine when a carrier will commence its transportation services.

The State of Alaska attempts to sidestep the same basic defect in its position by characterizing in advance any argument by TAPS owners that suspension would stop the pipeline as an attempt to intimidate the Commission unfairly. It argues, like the Bureau, that by allowing the Commission to set "lawful tariffs" the dilemma is solved. It goes further than the Bureau, however, by asserting that the instant proceedings are sufficient to determine "reasonable and lawful tariffs in place of those which should be suspended." (Alaska Protest/Complaint at 20). Accusations cannot substitute for legal analysis. Moreover, it is patently absurd to suggest that the full hearing required by § 15(1) can be condensed into the present summary context.

Having backed themselves into a corner by advocating suspension of original TAPS tariffs, protestants seek escape by urging the Commission to set interim rates at substantially reduced levels. This flies in the face of long-settled law arising from the plain requirements of § 15(1). The Commission cannot set rates until it first has conducted an adjudicatory hearing, providing full discovery and evidentiary rights to all interested parties, and second, based on the evidence adduced therein, has made a determination that the carrier-initiated rate is unlawful under the standards of the Act. Courts and commentators confronted with the apparent all-or-nothing result of the suspension

power in certain circumstances have recognized that it presents no dilemma but reveals the limits of the Act. For example, in Spritzer, *Uses of Summary Power to Suspend Rates,* 120 U. Pa. L. R. 39 (1971), the author, who advocates in favor of power in a rate-making agency enabling it to set interim rates, takes the law as he finds it. Speaking of the rate-making and suspension authority of the C.A.B., F.P.C. and I.C.C., he states:

> It is suggested that in such circumstances it would be permissible to grant rate relief during the course of a formal proceeding by an interim order based on interim findings. Existing statutory provisions, however, lack flexibility. An agency has discretion to suspend in toto or not at all. But there is no provision for the common situation in which an agency can make a preliminary judgment that a proposal appears justifiable in part and questionable in part. *Id.* at 43.

The solution to the problem of lack of flexibility is obvious, since the problem is the statute, the solution is legislative.

> An expeditious and satisfactory means of meeting such a situation would be for Congress to authorize rate-making agencies to allow partial and temporary increases, subject to appropriate conditions, at the time they exercise their power of suspension. *Id.*

Courts have similarly identified the problem of the all-or-nothing suspension as one arising from the limits of the statute and not from the perfidy of the regulated carrier. *Moss* v. *Civil Aeronautics Board,* 430 F. 2d 891 (D.C. Cir. 1970).

Protest Reply of Mobil Alaska.

1. Section 15(1) Requires the Commission to Conduct a Full Evidentiary Hearing Before It Can Prescribe Rates

Before the Commission may lawfully prescribe a tariff, it must provide the carrier a full hearing and, on the basis of the record adduced, determine that the carrier-initiated rate "is or will be unjust or unreasonable or unjustly discriminatory or unduly preferential or prejudicial. . . ." 49 U.S.C. § 15(1).

In determining whether a carrier-established rate is unreasonable, the Commission acts in a quasi-judicial capacity. *Morgan* v. *United States,* 298 U.S. 468 (1936); *Interstate Commerce Commission* v. *Louisville & Nashville Railroad Co.,* 227 U.S. 88 (1913). *Cf., United States* v. *Florida East Coast Railway Co.,* 410 U.S. 224 (1973). This function contrasts sharply with the Commission's summary powers to order suspension. *E.g., Arrow Transportation Co.* v. *Southern Railway Co.,* 372 U.S. 658, 671-72 (1963); *Port of New York Authority* v. *United States,* 451 F.2d 783 (2d Cir. 1971). While the power to suspend rates augments the greater power to prescribe rates, this scheme cannot be viewed backwards to allow the power to prescribe rates to mitigate the effects of the power to suspend. The Commission is without authority to cancel carrier rates on a summary finding of unreasonableness. *North Carolina Natural Gas Corp.* v. *United States,* 200 F. Supp. 745, 749 (D. Del. 1961).

The Supreme Court has left no doubt that the "full hearing" required by § 15(1) includes, *inter alia,* the due process requirements of the right to be fully apprised of the evidence submitted or considered, the opportunity to conduct discovery and offer evidence by way of explanation or

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rebuttal. *Interstate Commerce Commission* v. *Louisville & Nashville Railroad Co., supra.** In addition, the Court has directed that where a "full hearing" is a predicate to the finding of unreasonableness which triggers the power to set rates,

> [t]here must be evidence adequate to support pertinent and necessary findings of fact. Nothing can be treated as evidence which is not introduced as such. [citation omitted]. Facts and circumstances which ought to be considered must not be excluded. Facts and circumstances must not be considered which should not legally influence the conclusion. Findings based on the evidence must embrace the basic facts which are needed to sustain the order.
>
> • • •

* In so holding, the Court merely recognized the clear congressional intent embodied in § 15(1). Indeed, the congressional debate concerning whether to provide the Commission with the power of suspension left no doubt as to what was intended by the full hearing requirement of § 15(1). Speaking in support of the proposed suspension power, Senator Cummins described the requirements of such a hearing:

> . . . a hearing is required in every instance in which the commission seeks to set aside a rate established by the [carrier]. . . . Testimony is taken, arguments are presented, and at the end of such a proceeding the Interstate Commerce Commission either condemns the rate and prescribes another in its stead, or it dismisses the complaint.
>
> It is idle for anyone to assert that the commission can at any time set aside a . . . rate. The law as it is proposed in this bill does not change that in the slightest degree, except to give the commission the power to initiate this proceeding upon its own motion. But all the subsequent steps must be taken precisely as though it had been initiated upon complaint. I want that to settle firmly in the minds of Senators. It would not be tolerable even if it were the law that the commission could set aside rates simply upon a suggestion and without any inquiry whatever. 45 Cong. Rec. 6501 (1910).

> The requirement of a "full hearing" has obvious reference to the tradition of judicial proceedings in which evidence is received and weighed by the triers of facts. The "hearing" is designed to afford the safeguard that the one who decides shall be bound in good conscience to consider the evidence, to be guided by that alone, and to reach his conclusion uninfluenced by extraneous considerations which in other fields might have play in determining purely executive action. *Morgan* v. *United States, supra,* 298 U.S. at 480.

In addition to the above-mentioned minimum procedural rights necessary to satisfy the full hearing requirement of § 15(1), the Commission's General Rules of Practice, 49 C.F.R. Part 1100, afford parties substantial additional rights which are necessary to the exercise of a carrier's right to a full hearing. A party to a proceeding before the Commission may serve interrogatories (Rule 62), requests for admission (Rule 63), and, upon order by the Commission, take depositions upon oral examination (Rule 58) and inspect and copy documents (Rule 66). If Mobil Alaska's right to offer evidence in explanation or rebuttal is to be meaningful it must be afforded these pre-hearing discovery rights.*

Finally, Respondent's right to a full hearing before any Commission determination of the reasonableness of its tariffs includes the right of ultimate judicial review of an

* The Bureau of Investigation and Enforcement would have the Commission blatantly violate its own Rules of Practice, Rule 57, by ordering production of documents within the context of an informal suspension hearing and further by conditioning the right to refile after suspension on both the immediate production of some documents and an agreement to produce others within 30 days. Bureau's Protest and Petition at 9.

adverse Commission order. Pursuant to 5 U.S.C. § 702 and 28 U.S.C. §§ 2321(a), 2342, Mobil Alaska has a statutory right to secure a judicial determination of whether an order pursuant to § 15(1) exceeded the Commission's constitutional or statutory authority, was based on insufficient evidence, was arbitrary or capricious or otherwise unlawful. 5 U.S.C. § 706. Judicial review of suspension decisions is extremely limited.

In a suspension proceeding pursuant to § 15(7), the Commission's decision is governed by informal procedures drastically different from those necessary to comply with due process and the full hearing requirement of § 15(1). The statute itself makes this quite clear by authorizing the Commission to act "at once," with reasonable notice to affected carriers, but without formal pleadings, to suspend the proposed changes in tariffs. This practice is distinguished in § 15(7) from the full hearing required by § 15(1) by the additional proviso that if such a proceeding has not been completed within the suspension period, the rate change may be effectuated. In addition, Commission Rule 200, 49 C.F.R. § 1100.200, contemplates an informal hearing, without preparation of a transcript, and Rule 57 specifically precludes use of normal discovery devices in hearings governed by Rule 200. Moreover, the decision whether or not to suspend is a discretionary act which is reviewable only to determine whether the order exceeds the Commission's authority, *United States* v. *Chesapeake and Ohio Railway Co.*, 426 U.S. 500 (1976), or constitutes a gross abuse of discretion. *Naph-Sol Refining Co.* v. *United States,* 269 F. Supp. 530 (W.D. Mich. 1967). A suspension hearing does not and cannot satisfy the statutorily-mandated full hearing, which is a necessary prerequisite to Commission establishment of a rate. *Arrow Transportation Co.* v. *Southern*

Railway Co., 372 U.S. 658, 671-72, *North Carolina Natural Gas Corp.* v. *United States*, 200 F. Supp. 745, 749 (D. Del. 1961); *Bison Steamship Corp.* v. *United States*, 182 F. Supp. 63, 67 (N. D. Ohio 1960).

Thus, each of the statutory rights discussed above would be denied Mobil Alaska by a Commission decision to summarily suspend for purposes of unlawfully imposing a lower rate. First, Mobil Alaska would be denied the long-recognized right of initially setting its rate. Second, it would be denied its statutory rights to a full hearing before its rate is set aside as unreasonable by the Commission. Third, it would be denied the important procedural rights inherent in the "full hearing" requirement of § 15(1) under which it could determine the evidence on which a decision was based and offer evidence in explanation and rebuttal. It would be denied opportunity to present any adverse ruling to a court for meaningful judicial review.

2. A Conditional "No-Suspend" Order Would Constitute Commission Prescription of Rates

Protestants request that the Commission enter an order which suspends carrier-initiated rates over the Trans Alaska Pipeline System, but grants permission to the carriers to refile on one day's notice at a lower-rate level to be indicated by the Commission with assurance that new tariffs would not be suspended. Protestants necessarily describe such an order as one done on a permissive basis, seeking to inject connotations of voluntariness into the act of refiling tariffs pursuant to such an order. To companies like Mobil Alaska, with no source of revenue but TAPS operations, the choice between not operating and operating at a rate level lower than its own business needs require is no choice at all. To view acquiescence in conditional no-suspend order

as voluntary or in any way consistent with the Act's commitment to carrier-initiated rates would be engaging in fantasy. While the law engages in many legal fictions, it does not stoop to this sort of regulatory blackmail. As stated in *SCRAP* v. *United States*, 346 F. Supp. 189 (D.D.C. 1972), *rev'd on other grounds*, 412 U.S. 669, (1973):

> [a] suspension decision which effectively blackmails the carriers into submitting agency-authorized rates is functionally indistinguishable from an agency order setting those rates. . . . 346 F. Supp. at 197.

The Commission is not at liberty to evade its statutory mandate and its own procedures by exacting a rate through severe economic pressure. This is the message of *Moss* v. *CAB*, 430 F.2d 891 (D.C. Cir. 1970). In a factual circumstance strikingly like the one posited by protestants' requests for relief, the Court of Appeals for the District of Columbia rejected a conditional no-suspend order as unlawful. Major air carriers, subject to a statutory scheme identical in relevant part to the Interstate Commerce Act, filed across-the-board rate increases at the CAB. Upon oral argument scheduled on its own motion the CAB entered an order suspending the rates. However, recognizing the carrier's need for increased revenue, the Board outlined a tariff formula which it would allow to be implemented without suspension. Carriers immediately withdrew their proposed tariffs and filed new ones conforming to the Board's formula. In ensuing litigation, the CAB defended its action as mere suggestion. It contended that so long as rates were not specifically ordered, they remained carrier-made rates. The court rejected the Board's contention and found that in the face of the carrier's urgent need for additional revenue, the threatened use of the Board's power to sus-

pend rates in excess of the "suggested" ones constituted economic coercion and prescription of rates by the Board. Further, the court invalidated the tariffs as unlawfully adopted in violation of the statutory requirements of notice and hearing over the Board's objection that such action would "hobble the administrative process." *Id.* at 900.

Other courts have recognized the potential for economic coercion behind such agency "suggested rates." In *National Association of Motor Bus Owners* v. *Federal Communications Commission*, 460 F.2d 561, 567 (2d Cir. 1972), the court stated:

> In *Moss*, therefore, the airlines' "discretion" was so circumscribed as to have been almost nonexistent. The situation was not such that the airlines in fact had an option to choose between alternatives.

The same kind of coercive use of the agency's suspension power was at issue in *Delta Air Lines* v. *CAB*, 543 F.2d 247 (D.C. Cir. 1976), although in that case the CAB had used its power to prescribe tariff regulations rather than tariff rates.

The Bureau recognizes the applicability of *Moss* to the course of action it suggests. To avoid its effect the Bureau makes the incredible suggestion that if the Commission merely takes the transparent, ineffectual additional step of specifically stating that it is not prescribing a rate within the meaning of *Arizona Grocery* v. *Atchison Topeka & Santa Fe Railway Co.*, 284 U.S. 370 (1932), it can avoid the "procedural problems" of *Moss* v. *CAB*. This suggestion ignores not only the fact that *Arizona Grocery* constituted the main line of the CAB's unsuccessful defense in *Moss* v. *CAB*, but also that the entire thrust of *Moss* and its progeny is that courts will look through the form of agency action

to discover its substance. A self-serving declaration to the effect that the Commission is not prescribing a rate will not cloak the fact that the Commission, through the combined effects of its purported suspension power and economic coercion, will have supplanted carrier-established rates with agency-prescribed ones without conducting the full hearing upon which such action must be predicated.

Other aspects of protestants' scheme to lower the TAPS tariffs via Commission order remain unclear and are difficult to square with the requirements of the Act. It is not clear, for example, whether protestants intend the new rates to remain in effect permanently or only during the statutory suspension period, nor is it clear whether the formal investigation which would be instituted is intended by protestants to examine the carrier-initiated rate or the refiled rate. The Bureau takes the amazing position that once a TAPS owner succumbs to the economic lever of suspension, any resulting investigation would examine the refiled Commission-prescribed rate. Under this perverse view of regulatory justice, TAPS carriers unable to face total loss of revenues for seven months would be wholly deprived of any opportunity to defend its own rate. The Bureau also seeks to impose a refund obligation on the refiled tariffs, but avoids confronting the inconsistency of this request with the statutory bar to reparations from Commission-prescribed or approved rates.

The Commission, in sum, must not grant protestants' requests. The requisite statutory authority is clearly lacking, and the projected results of any such action would be so bizzare as to strongly suggest a regulatory quagmire of unrivaled dimension.

II

SUSPENSION OF MOBIL ALASKA'S TAPS TARIFF WOULD BE A DENIAL OF DUE PROCESS

Should relief as requested by protestants be ordered, Mobil Alaska would suffer irretrievable loss of property without the protections guaranteed by the Constitution. Suspension and prescription of new rates on an interim basis will result in the immediate loss of millions of dollars on the basis of a summary proceeding. The minimum protections of the Due Process Clause require much more than these summary proceedings can provide.

A suspension of TAPS owners' tariffs, with or without a condition permitting operations at substantially lower rates, would severely penalize TAPS carriers on ground that their rates are presumptively unlawful. This drastic result would be achieved by consideration of allegations untested by the procedures which could expose a factual basis for decision.

Assertions that the Commission's authority pursuant to § 15(7) allow a suspension in the present circumstance cannot provide escape from the procedural rights conferred by § 15(1). Mobil Alaska's protection against the loss which is threatened by grant of protestants' request is not dependent upon matters of statutory construction. The statutory right to a full hearing merely captures constitutional rights which exist apart from the language of the Act. The Supreme Court early articulated the constitutional basis of § 15(1) in *Interstate Commerce Commission* v. *Louisville-Nashville R. Co.*, 227 U.S. 88 (1913). There the Court praised procedures exposing facts as necessary to foreclose arbitrary exercises of government authority:

> [Section 15(1)] gave the right to a full hearing, and that conferred the privilege of introducing testimony, and at the same time imposed the duty of deciding in accordance with the facts proved. A finding without evidence is arbitrary and baseless. And if the government's contention is correct [that a Commission determination is conclusive], it would mean that the Commission had a power possessed by no other officer, administrative body, or tribunal under our government. It would mean that, where rights depended upon facts, the Commission could disregard all rules of evidence, and capriciously make findings by administrative fiat. Such authority, however beneficently exercised in one case, could be injuriously exerted in another, is inconsistent with rational justice, and comes under the Constitution's condemnation of all arbitrary exercise of power. 227 U.S. at 92.

No evidence will form the basis for a decision to lower TAPS owners' revenues via the suspension powers of § 15(7). Mobil Alaska will have no meaningful opportunity to confront its challengers with its own extensive evidence in support of its rate making, nor will it be able to illuminate that evidence with the testimony of experts critical of the new methodologies and economic theories advanced by protestants. The basis of protestants allegations will not be proffered and tested by cross-examination. If an order effectively sets a rate, it is effectively a finding of unlawfulness; such order would be constitutionally defective without a fair opportunity to meet the case against it by means of cross-examination and rebuttal evidence. *Southern Ry. Co.* v. *Virginia*, 290 U.S. 190 (1933). As

stated in *Chicago, Milwaukee & St. Paul Ry Co.*, 134 U.S. 418 (1890),

> The question of the reasonableness of a rate of charge for transportation by a railroad company, involving as it does the element of reasonableness both as regards the company and as regards the public is eminently a question for judicial investigation, requiring due process of law for its determination. If the company is deprived of the power of charging reasonable rates for the use of its property, and such deprivation takes place in the absence of an investigation by judicial machinery, it is deprived of the lawful use of its property, and thus, in substance and effect, of the property itself, without due process of law and in violation of the Constitution of the United States; and in so far as it is thus deprived, while other persons are permitted to receive reasonable profits upon their invested capital, the company is deprived of the equal protection of the laws. 134 U. S. 458.

The plain effect of a suspension or prescription of interim rates in the present circumstance is identical to a finding of unlawfulness under the Act. Characterizing such decision as a suspension rather than a finding of unlawfulness cannot, however, avoid meeting the obligations of the due process clause. The form of an administrative action cannot avoid the requirements of due process. *Morgan* v. *United States*, 304 U. S. 1 (1938); *KFC National Management Corp.* v. *N.L.R.B.*, 497 F.2d 298 (2d Cir. 1974), *cert. denied*, 423 U. S. 1974 (1976); *Sangamon Valley Television Corp.* v. *United States*, 269 F.2d 221 (D.C. Cir. 1959); *Philadelphia Co.* v. *United States*, 175 F.2d 808 (D. C. Cir. 1948),

vacated on joint motion of counsel as moot, 337 U. S. 901 (1949).

Certainly, the prospect of a formal investigation and hearing commencing after the effects of the conclusive suspension order were felt would neither mitigate nor cure the violations incurred. Prior notice, hearing, and preparation of a reviewable record are fundamental rights embodied in the due process clause. *North American Van Lines, Inc.* v. *United States*, 412 F. Supp. 782 (N. D. Ind. 1976). A hearing required as a prerequisite to action means a hearing prior to determination; hearing after determination is made is insufficient. *Civil Aeronautics Board* v. *Delta Airlines*, 367 U. S. 316, 331 n. 13 (1961).

The Bureau's request that a suspension-order be conditioned on imposition of a burdensome discovery obligation highlights protestants' backward approach to evaluation of TAPS rates. This massive amount of factual evidence sought by the Bureau to formulate its case against the carrier-initiated TAPS rates is precisely that which should form the basis of the order. However, the Bureau's request would concede the absence of such evidentiary basis in the very order itself.

Moreover, without such factual evidence in the record, meaningful review of an agency order is foreclosed. Without the record of a hearing, there is nothing to review for conformity to the evidence or for conformity to statutory standards. *NLRB* v. *Metropolitan Life Ins. Co.*, 380 U. S. 438 (1965); *ICC* v. *J-T Transp. Co.*, 368 U. S. 81 (1961). Thus, in *Burlington Truck Lines, Inc.* v. *United States*, 371 U. S. 156 (1962), the Supreme Court invalidated an order of the interstate Commerce Commission which did not sufficiently disclose the grounds of the action taken with the following words:

> The Commission must exercise its discretion within the bounds expressed by the standard 'public convenience and necessity'. And for the courts to determine whether the agency *has* done so, it must disclose the basis of its order and give clear indication that it has exercised the discretion with which Congress has empowered it. The agency must make findings that support its decision, and those findings must be supported by substantial evidence. 371 U. S. at 167-68.

The sum of the protestants' arguments to the Commission boil down to the proposition that the tariffs here are unreasonable and will be found to be so upon full investigation; therefore, any power which the Commission could exercise before a full adjudicatory hearing may be exercised now. It is an argument of expediency to obtain the fruits of a prejudgment of issues which necessarily will take months to fully explore. While protestants exhibit few qualms over the inequity of the relief which they seek, they ignore formidable statutory and constitutional barriers to the course of action they propose. The primary damage claimed by protestants from denial of their requested relief is private harm, unrelated to the concerns of the Commission's statutory charter. Even if a public interest factor corresponding to the potential harm to Mobil Alaska were present, it could not override constitutional guarantees. Similarly, if the present circumstances are viewed as unique and outside the situations contemplated by the Act, a perceived need for change cannot be effected by administrative recodification. "[D]ue process in administrative hearings does not yield to administrative 'convenience or expediency, or because of a natural desire to be rid of harrassing delay. . . .'" *Fitzgerald* v. *Hampton*, 467 F.2d 755, 767 (D. C. Cir. 1972, *quoting Ohio Bell Telephone Co.* v. *Public Utilities*

Commission of Ohio, 301 U. S. 292, 305 (1937). Due process requires that a full and fair adjudication of the challenged TAPS tariffs be conducted before the confiscatory action sought by protestants lawfully could be ordered.

CONCLUSION

The Commission should respond to the allegations set forth in the protests by immediately instituting a formal hearing. The Commission cannot, however, grant the suspension relief requested, nor fashion an order achieving lowered TAPS rate levels without exceeding its statutory authority and violating Mobil Alaska's constitutional right to due process of law. The protests should be denied in all respects.

Dated: June 22, 1977

Respectfully submitted,
DONOVAN LEISURE NEWTON & IRVINE

ANDREW J. KILCARR, ESQ.
MAUREEN E. O'BRYON, ESQ.
1666 K Street, N.W., Suite 301
Washington, D.C. 20006

Of Counsel:

JAMES R. KINZER, ESQ.
General Counsel
Mobil Alaska Pipeline Co.
P. O. Box 900
Dallas, Texas 75221

[Certificate of service omitted in printing.]

Reply of Exxon Pipeline Co. to Protests, June 22, 1977.

BEFORE THE
INTERSTATE COMMERCE COMMISSION
WASHINGTON, D.C.

EXXON PIPELINE COMPANY,
LOCAL TARIFF, I.C.C. No. 125

Rates Applying In The Transportation Of Petroleum Through The Trans Alaska Pipeline System And Loading In Vessels For Destinations Outside Alaska

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REPLY OF
EXXON PIPELINE COMPANY TO PROTESTS

[Caption Omitted in Printing]

Protest Reply of Exxon Pipeline.

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BEFORE THE

INTERSTATE COMMERCE COMMISSION

WASHINGTON, D.C.

EXXON PIPELINE COMPANY
LOCAL TARIFF, I.C.C. No. 125

Rates Applying In The Transportation Of Petroleum Through The Trans-Alaska Pipeline System And Loading In Vessels For Destinations Outside Alaska.

REPLY OF EXXON PIPELINE COMPANY TO PROTESTS

Exxon Pipeline Company (Exxon) submits the following as its reply to the protests and petitions for suspension of its initial interstate rate filed for transportation through the Trans-Alaska Pipeline System:

PRELIMINARY STATEMENT

Exxon owns an undivided twenty percent (20%) interest in the Trans-Alaska Pipeline System (TAPS), a pipeline system constructed to transport crude oil some 800 miles from Prudhoe Bay to Valdez, Alaska. On June 8, 1977, pursuant to Sections 1 and 6 of the Interstate Commerce Act (the Act), Exxon filed a tariff schedule setting forth an initial rate of $6.27 per barrel to apply to the transportation of crude oil through its portion of TAPS.

The seven other joint owners have also filed tariffs of initial rates. The following table lists all of the joint owners, their respective interests in TAPS, their I.C.C. tariff numbers, and their proposed initial rate per barrel:

Protest Reply of Exxon Pipeline.

TABLE 1

Joint Owners of TAPS and Proposed Rates

Carrier	Interest in TAPS	I.C.C. Tariff No.	Proposed Initial Rate per Barrel
Amerada Hess Pipeline Corp.	1.50%	1	$6.44
ARCO Pipe Line Co.	21.00	1030	6.04
BP Pipelines, Inc.	15.84	2	6.35
Exxon Pipeline Co.	20.00	125	6.27
Mobil Alaska Pipeline Co.	5.00	2	6.31
Phillips Alaska Pipeline Co.	1.66	2	6.22
Sohio Pipe Line Co.	33.34	742	6.16
Union Alaska	1.66	2	6.09

On June 15, 1977, protests and petitions for suspension and investigation were filed by the State of Alaska (Alaska), the Arctic Slope Regional Corporation (ASRC), the United States Department of Justice (DOJ), and the Commission's Bureau of Investigations and Enforcement (Bureau). Each of these protestants contends that each of the rates filed is excessively high in violation of Section 1(5) and other provisions of the Act and should be suspended and investigated. Each protestant, while contending that the rates as filed should be suspended, states that the TAPS carriers should be given special permission to file, on one day's notice, tariffs containing substantially lower initial rates. The range of reduced initial rates per barrel proposed by the protestants is as follows:

Protest Reply of Exxon Pipeline.

TABLE 2

Protestants' Proposed Reduced Rates

Protestant	Range (per barrel)	Rate Proposed for Exxon
State of Alaska	$3.59-$4.42	$3.80-$3.99
Arctic Slope Regional Corp.	$3.04-$3.44	$3.27
Department of Justice	$4.40-$4.60	$3.88-$4.49
Bureau of Enforcement	$4.54-$5.00	$5.00

These proposed initial rates are as much as $3.00 per barrel lower than those proposed by the TAPS carriers, including Exxon.

As a general proposition, the protestants rest their proposed initial rates on unique standards of pipeline ratemaking which are not employed by the pipelines themselves or by this Commission. Moreover, each protestant, with the exception of the Bureau, either directly or indirectly challenges the Commission's existing methodology for determining the valuation of pipeline property and for examining the reasonableness of pipeline rates in light of the resulting rate of return on such valuation.

It is the position of Exxon that the various protests and petitions for suspension and investigation filed with respect to its proposed initial rate should be summarily denied and the proposed initial rate allowed to become effective as scheduled. The rate calculations made by the individual protestants to support their respective proposed initial rates are, for the most part, based on assumptions and principles foreign to the Commission's methodology for pipeline ratemaking. Issues involving the Commission's valuation methodology for common carrier pipelines are already before the Commission in Ex Parte No. 308, *Valuation of Common Carrier Pipelines.* To the extent that any

of the protestants challenge or attempt to modify existing Commission doctrine on these issues, their protests are clearly beyond the scope of this proceeding and should be ignored.

The reduced rates proposed for Exxon by the protestants would reduce the revenues received by Exxon to such an extent that its participation in the operation of TAPS would be financially indefensible. Moreover, while the shippers are fully protected from overcharges by the provisions of the Act, if the Commission were ultimately to conclude that Exxon's rate was in fact a proper rate, Exxon could never recover the revenues lost by interim application of a reduced rate. Exxon and the other owners of TAPS participated in the Trans-Alaska project with the expectation that once the project was completed, they would be able to recover a fair return on the enormous sums of money they had invested. The approach and the rates advocated by the protestants herein would result in serious financial losses for the owners of TAPS, and, at the same time, discourage further energy initiatives by the joint owners and other companies.

The only responsible decision which the Commission can make is to allow the rates as filed to go into effect, subject to investigation, if required. To decide otherwise would be unfair to the carriers involved herein and harmful to the public interest. The rate proposed by Exxon is fully justified and the protests against that rate have no factual basis or legal support, as the following discussion shows.

ARGUMENT

I. The Circumstances Surrounding TAPS Compel the Commission to Refuse to Suspend the Initial Rates Filed by the TAPS Owners

A. The Commission Should Not Exercise Its Suspension Power Unless Proposed Rates Are Shown To Be Clearly Unlawful

The Supreme Court has recently described the Commission's suspension power in the following terms (*United States* v. *Chesapeake & Ohio R. Co.*, 426 U.S. 500, 512-513 (1976)):

> "The power to suspend the proposed rates pending investigation—the regulatory tool at issue here—was added to the Interstate Commerce Act by the Mann-Elkins Act of 1910, 36 Stat. 552. Its purpose was to protect the public from the irreparable harm resulting in unjustified increases in transportation costs by giving the Commission 'full opportunity for . . . investigation' *before* the tariff became effective. It provided a 'means . . . for checking at the threshold new adjustments that might subsequently prove to be unreasonable or discriminatory, safeguarding the community against irreparable losses and recognizing more fully that the Commission's essential task is to establish and maintain reasonable charges and proper rate relationships.' 1. Sharfman, *The Interstate Commerce Commission* 59 (1931). The exigencies of competition, seasonal and other demand trends, and the influences of the general economy over a seven-month period can make implementation of this suspension mechanism a particularly potent

> tool. That potency was well recognized, even at its creation. Senator Elkins referred to it as a 'tremendous power.' Senator Cummins characterized it as 'an order in the nature of a preliminary injunction'. . . ." (footnotes deleted)

As a "particularly potent tool," suspension must be exercised judiciously and only when the Commission is convinced that the rates are in fact unjust and unreasonable.[1]

B. Initial Rates Are Presumed To Be Lawful

When an initial rate is filed by a carrier, the burden of proof is upon protestants to show why that rate should not be allowed to become effective. As the Commission long ago held:

> "[C]arriers are authorized to establish, in the first instance, their transportation charges, and the presumption of right doing attaches to their acts in the establishment of those rates." *Banner Milling Co.* v. *New York Central & Hudson R.R.*, 14 I.C.C. 398 (1908).[2]

1. As noted above, the suspension of rates has been characterized as "an order in the nature of a preliminary injunction." *United States* v. *Chesapeake & Ohio R. Co., supra,* 426 U.S. at 513 (1976). Thus, exercise of the Commission's suspension power should rest upon a showing (1) that the protestant will ultimately prevail in its contention that the rate is unlawful (2) that the protestant will be irreparably injured if the rate is not suspended, (3) that suspension will not cause harm to others, and (4) that the public interest is served by suspension. *Virginia Petroleum Job. Ass'n* v. *Federal Power Comm'n*, 259, F.2d 921, 925 (D.C. Cir. 1958).

2. Regarding the presumption of good faith and proper conduct by carriers filing rates, *see West Ohio Gas Co.* v. *Ohio Pub. Util. Comm'n*, 294, U. S. 63, 72-73 (1935) and *Interstate Commerce Comm'n* v. *Chicago Great Western R. Co.*, 209 U.S. 108, 119-120 (1908) ("The presumption of honest intent and right conduct attends the action of carriers . . . These presumptions of good faith and integrity which have been recognized for ages as attending human action have not been overthrown by any legislation in respect to common carriers.").

More recently, the Commission clarified the difference between the burden of proof in a proceeding involving a "changed" rate and one involving an initial rate:

> "Of particular significance are the express terms found in sections 15(7) and 307(g). Each provides for suspension and/or investigation of ' . . . a new rate . . . ' which encompasses both changed and initial. However, each section places the burden of proof upon the proponent of only a 'changed' rate. The distinction between the meaning of the two terms becomes readily apparent from the excepted provisions of section 307(g) which 'shall not apply to any *initial* (emphasis added) schedule filed prior to October 1, 1941 . . . ' Further support for this distinction is found in section 307(i) relating to water contract carriers . . . [W]ithin the entire statutory framework, there is consistently recognized an express difference between an 'initial' and a 'changed' rate, and express identification of the parties upon whom the burden of proof falls. Such is consistent also with the provisions of section 7(c) of the Administrative Procedure Act, whereby the proponents of an order such as the protestants of an 'initial' rate proposal, have the burden of proof." *Rail-Water, Grain In Bulk, Mo., Ill., And Ind. to Buffalo,* 321 I.C.C. 564, 566-567 (1963).[3]

3. For other Commission decisions holding that the burden of proof is on the parties protesting initial rates, *see Bituminous Coal, Motor-Rail, Lynnville, Inc., To Chicago,* 313 I.C.C. 573, 574 (1961); *New York Central R. Co., Station At Jay Street Terminal,* 310 I.C.C. 211, 212 (1960); *Cotton From New Orleans,* 49 I.C.C. 751, 753 (1918); *Bay State Milling Co.* v. *Transit Corp.,* 43 I.C.C. 338, 347 (1917).

Thus, the suggestion in the Department of Justice's protest (pp. 8-9), that the burden of proof in this suspension proceeding is somehow on the pipeline carriers is simply wrong. Before the Commission can suspend the initial rates filed by Exxon and the other joint owners, it is the protestants who must overcome the presumption that those proposed rates are lawful. As the following sections of this Reply will show, the protestants have failed to sustain this burden.

C. Suspension Of Exxon's Initial Rate Would Be An Abuse Of Commission Discretion

The core issued in this proceeding is not whether the Commission, after a hearing, may find that the proposed initial rate filed by Exxon requires adjustment, but whether the Commission should now exercise its discretionary power to suspend that rate. The Commission's decision must take into account and must reflect a balancing of equities among the pipeline carrier, the oil producers, the refineries, the public, and the State of Alaska.

Exxon submits that when the Commission has properly balanced all of these interests and has considered all of the circumstances its decision must be that it will not exercise its suspension power. To decide otherwise would be a gross abuse of the Commission's discretion.

The consequences to the TAPS carriers, the oil producers, and the public which would flow from a decision to suspend the rates of the TAPS carriers are so staggering that they simply must not be permitted to happen. As the Bureau frankly admits in its Protest (p. 35), a suspension of these initial rates "does not merely postpone increases, but rather stops all operations, and hence some rates must be allowed."

As discussed below, under its suspension powers the Commission options are limited to permitting the rates filed to go into effect or suspending such rates; it has no power to prescribe a different rate absent a full hearing. Accordingly, if the rates are suspended, the TAPS carriers will be deprived of revenues (in excess of $7 million per day at full operation) during the period of the Commission's investigation; in addition, they would be forced to incur the very sizable expense of maintaining the pipeline system on a standby basis. Similar consequences would be visited upon the oil producers who would be required to terminate production, yet maintain their facilities on a standby basis.

If the oil does not flow through the pipeline, substantial losses will also be experienced in respect to the vessels now scheduled to call at Valdez. A significant marine fleet has been organized to transport crude oil from Valdez to the lower forty-eight states. Many of these vessels are either firmly scheduled to call at Valdez or are in shipyards being converted to Alaskan crude service and cannot readily be diverted or outchartered to other uses. For the most part, these vessels would either be on nonproductive standby or would have to be repositioned at substantial cost.

West Coast refineries also will be seriously affected by suspension of the TAPS rates. Due to the lead time for arranging supplies of crude oil, some West Coast refineries have terminated existing supply arrangements in anticipation of receiving crude oil from Alaska's North Slope. If deliveries of that oil are delayed, there is a serious risk that some of these refineries will exhaust their supplies of crude oil before temporary crude supplies can be obtained from other sources.

A decision to suspend the rates of the TAPS carriers, will thus halt the production of crude oil which would other-

wise reduce significantly the amount of oil imported into the United States. When TAPS is operating at current design capacity the Nation's balance-of-payments deficit will be reduced by some $16 million per day. In addition, the State of Alaska, which ironically has asked that the rates be suspended, will lose royalty and tax revenues during the period of investigation seriously affecting its budgetary processes.

These serious and irreparable consequences flowing from a decision to suspend must be weighed against the adverse effects of a decision *not* to suspend. The only arguably adverse consequences of that decision are that shippers of crude oil from Alaska's North Slope will, in the first instance, be assessed transportation charges at a rate higher than protestants claim that they should be and that the State of Alaska will receive royalties calculated on the basis of a per barrel value lower than the State would like to have. But even if protestants, after a hearing, should sustain their contentions that the rates of the TAPS carriers are excessive, these interim effects of the application of the rates as filed are not irreparable.

Shippers and other affected parties have available the option of filing a complaint under section 13 of the Act, 49 U.S.C. § 13, and seeking reparations under section 16, 49 U.S.C. § 16, in the event that the TAPS carriers' rates are found to be too high. The TAPS carriers and the Commission are currently in the preliminary stages of the statutory valuation process during which the Commission will present a tentative valuation of each carrier's property, subject to protest by any interested party within 30 days (49 U.S.C. § 19a (h). If the tentative valuation is protested, the Commission must hear and consider any evidence in support of the protests and it may make any changes in its valuation

it deems necessary before the valuation becomes final (49 U.S.C. § 19a(i)). Section 19a(i) provides that:

> "All final valuations by the commission and the classification thereof shall be published and shall be prima facie evidence of the value of the property in all proceedings under this chapter as of the date of the fixing thereof, and in all judicial proceedings for the enforcement of this chapter, and in all judicial proceedings brought to enjoin, set aside, annul, or suspend, in whole or in part, any order of the Interstate Commerce Commission."

Thus, it is clear that the various protestants should present any evidence they have regarding the TAPS carriers' rate base in the valuation proceeding which will soon be forthcoming and not in this suspension proceeding. If the protestants find the Commission's tentative valuation objectionable and are successful in changing the final valuation, that final valuation will serve as prima facie evidence in any investigation of the propriety of the filed rates and in any proceedings for the recovery of reparations for overcharges.

An examination of the Commission's procedures for determining valuation, investigating rates, and awarding reparations clearly shows that the protestants herein will be fully protected by allowing the carriers' initial rates as filed to become effective as scheduled. The protestants will have the opportunity to challenge the valuation rate base in the valuation proceeding and the rate of return on valuation in any investigation of the proposed rates.

In the Trans-Alaska Pipeline Authorization Act, the Congress has declared that the "early development and delivery of oil and gas from Alaska's North Slope to domestic

markets is in the national interest because of growing domestic shortages and increasing dependence upon insecure foreign sources" and that the earliest practicable delivery of extensive reserves of low-sulfur oil from the North Slope "will best serve the national interest" (43 U.S.C. § 1651).

In light of the foregoing, a decision by the Commission to suspend the rates of the TAPS carriers would be wholly irresponsible and a flagrant abuse of its discretion unless the Commission is convinced beyond all doubt and decides that those rates are in fact unlawful on their face. The Commission cannot make that decision, since, as discussed below, the rate filed by Exxon was developed in the manner by which the Commission has traditionally calculated pipeline rates and is manifestly reasonable when tested by any proper standard.

II. Exxon's Initial Rate Was Constructed In Accordance With Established Commission Practice

The Commission's role in this suspension proceeding is relatively simple. In exercising its discretion to suspend or not suspend, all that this Commission should do is to examine the rate filed by Exxon to determine whether or not that rate has been established in accordance with the practices conventionally accepted by this Commission. If it has been, the Commission should refuse to suspend the rate leaving the protestants and other affected parties to pursue their remedies under the Act.

As discussed below, this Commission has already ruled that far-reaching changes in the way in which pipelines are regulated, and which have an industry-wide impact, are not the proper subject for an individual pipeline rate proceeding, even in the course of a full investigatory hearing.

Clearly then, such matters are wholly inappropriate in a suspension proceeding. Similarly, as discussed more fully below, complex factual questions, such as those raised concerning construction costs and practices in the Arctic, are properly the subject of full investigation in a valuation proceeding or a rate investigation and cannot be dealt with in the context of a suspension proceeding.

In the case of Exxon's $6.27 rate, the Statement of Ernest C. Terry, filed herewith as Appendix A, shows that this rate was not only constructed in accordance with the standard practices employed by this Commission and the regulated pipelines, but that the rate is actually less than could have been justified.

As Mr. Terry's statement shows, Exxon's rate is based on an estimated valuation for TAPS, employing the valuation methodology described by Jesse C. Oak, Senior Valuation Engineer, Bureau of Accounts, of the Interstate Commerce Commission, in his testimony in Ex Parte No. 308, dated March 25, 1977. The estimated valuation employed for Exxon's 20% share was $1,976,500,000.

In arriving at this valuation, Mr. Terry used original cost figures which were supplied by Alyeska Pipeline Service Company to the Interstate Commerce Commission, even though later estimates would indicate that the original cost will be somewhat higher. Cost of reproduction-new was estimated through use of indices of the kind regularly employed by the Valuation Section of the Commission.

In constructing an initial rate, Exxon determined that, even though it would produce a substantially higher rate, it should not base its calculations on the start-up year, 1977. Simply because it is the start-up year, the throughput which can be achieved is not representative of the anticipated throughput when the pipeline is operating at current design capacity. Instead, Exxon first calculated a rate of $6.53 on

the basis of 1978 estimates at current design throughput, 1978 being the first full year of operation. In making this calculation, Exxon used estimates of 1978 operating costs supplied by Alyeska, depreciation based on a 25-year life, an allowance for future removal and restoration costs required to meet conditions imposed by the State and Federal governments, interest expense reflecting Exxon's average interest rate of 8% on outstanding debt invested in its share of TAPS, and State and Federal income taxes at the statutory rates. The basis for Exxon's selection of a 25-year depreciation period and its treatment of removal and restoration costs are set forth in Mr. Terry's Statement and in Attachments III and IV thereto. These matters are also discussed elsewhere in this Reply.

In calculating return on valuation, Exxon employed what it believes to be the standard practice before this Commission, i.e., in determining return, Exxon treated interest costs as an expense. The propriety of using this method of calculating return is discussed at length below in connection with the response to the attempt of the Bureau of Investigations and Enforcement to require use of a different method. Because Exxon is subject to the 1941 Consent Decree entered in *United States* v. *Atlantic Refining Co.*, C.A. No. 14060, D.D.C., limiting the dividends which can be paid by it to its parent company, the rate of return on valuation employed in constructing the rate was limited to 7%.

Exxon also elected to use the design capacity of TAPS (1.2 million barrels per day) as the measure of anticipated throughput in calculating revenues, although it is obvious that, even if the pipeline operates at 100% efficiency, the *revenue* throughput will be less. The Exxon tariffs provide for payment of transportation charges by shippers only for the volumes delivered to shippers. No transportation

charges are paid on the volumes of fuel required to operate pump stations along the line. The total fuel requirements for TAPS are estimated to be 1.5 million barrels per year. Similarly, no allowance was made for reductions in throughput due to operating conditions, although industry experience indicates that even pipelines operating under proration (i.e., where the volumes tendered exceed capacity) are not able to operate at 100% of capacity.

In addition to fuel requirements and operating conditions, throughput is also dependent on governmental actions and shippers' production rates. *The Washington Post* of June 20, 1977, states that the President's energy advisers are considering temporarily limiting production of Alaskan oil to West Coast needs, which are far below the capacity of the pipeline. Similarly, in a registration statement filed with the Securities and Exchange Commission on June 14, 1977, the British Petroleum Company Limited (BP) advised the public that, due to the lack of an in-place overland transportation system from the West Coast to other markets and a shortage of U.S.-flag tanker capacity, its affiliate, Sohio, would not be in a position in late 1977 and 1978 to take or otherwise dispose of its full entitlement of North Slope crude oil production, unless restrictions on the export of North Slope crude oil or the requirements of the Jones Act were modified. Sohio's share, at a production level of 1.2 million barrels per day, is approximately 637,860 barrels per day. The BP registration statement points out that the effect of Sohio being unable to take its proportionate share of the production could be to reduce the throughput of TAPS below the design capacity of 1.2 million barrels in both 1977 and 1978.

The rates required for TAPS are extremely sensitive to volume. Exxon's adoption of a rate base on system design capacity is almost certain to result in under-collections, with a consequent reduction in return.

As shown in Attachment V to Mr. Terry's statement, the rate resulting from using 1978 estimates and the methodology described above would be $6.53 per barrel. Based upon throughput reflecting system design, however, the adoption of that rate as an initial rate would have required Exxon to file a reduced rate, effective January 1, 1979, to reflect changes in expenses and to keep earnings within the 7% limit imposed by the Consent Decree. Believing that rate stability is of importance to shippers and to the pubic, Exxon explored other measures in an attempt to avoid the necessity for early and frequent rate changes. The Consent Decree permits pipelines operating under its terms to carry forward dividend deficiencies for a period of three years. This provision enables Exxon to establish an initial rate reflecting the average anticipated experience during the first four full years of operations. In determining such a rate, Exxon again utilized the present design capacity of the pipeline to estimate throughput for the first three years and its current forecast of an expansion of the system, effective July 1, 1981. The 1981 throughput volumes used in the calculation for Exxon were 240,000 barrels per day from January 1, through June 30, and 308,600 barrels per day from July 1 to December 31. Adjustments were made to operating expenses, depreciation, and interest charges to reflect both the passage of time and the forecasted expansion.

As shown in Attachment VI to Mr. Terry's statement, the result of using the average for the years 1978-1981, rather than using the year 1978 alone is to reduce the initial rate from $6.53 per barrel to the $6.27 rate proposed by Exxon (see Table 3).

Assuming that the throughput is equivalent to design capacity, the average return on valuation, calculated by treating interest as an expense, would be 7%. However, as

EXXON PIPELINE COMPANY TAPS TARIFF COMPUTATION

	$\overline{MS}$				
	1978	1979	1980	1981	1978-1981 Average
Revenue	572.0	567.4	563.2	571.5	568.7
Operating Expense					
Alyeska Field and Administrative	44.8	47.0	49.4	57.1	49.6
Topping Plant Fuel and Natural Gas	4.5	4.6	4.7	6.1	5.0
Exxon Pipeline Company Administrative	.7	.7	.8	.8	.8
Ad Valorem Taxes	31.9	31.9	31.9	32.8	32.1
Book Depreciation	73.7	73.7	73.7	75.8	74.2
TAPS Dismantling	16.4	16.4	16.4	16.4	16.4
Interest Expense	114.5	106.7	98.7	92.6	103.2
Taxable Income					287.4
Provision for Income Taxes					149.1
Earnings					138.3
Throughput—$\overline{MB}$	87.60	87.60	87.60	100.22	90.75
ICC valuation					1,976.3
Return on Valuation—%					7.0
Tariff Rate—$/bbl.					6.27

noted above, Exxon will not have revenue throughput equal to its share of design capacity even if the pipeline operates at 100% efficiency, and there is no rational basis to anticipate that the pipeline will operate at 100% efficiency.

In order to secure a more realistic picture of the short-term financial results to be expected from the adoption of the $6.27 rate, Exxon prepared a forecast for the years 1977 and 1978, estimating a loss of capacity of 10% for 1977 due to the uncertainties of start-up and operating conditions and 5% for 1978. These estimates of loss of capacity do not reflect potential restraints on throughput such as the imposition of government controls on production or the inability of any of the producers to take their full share of production. Based upon this analysis, as shown in Attachment VII to Mr. Terry's statement, under the $6.27 rate, the return on valuation would be only 5.4% for 1977 and 5.8% for 1978, rather than the 7% used in constructing the $6.27 rate.

On the basis of the methods of determining the reasonableness of pipeline rates which this Commission regularly employs, it is clear that Exxon's $6.27 initial rate is not unreasonably high. Indeed, there is sound basis for an argument that the rate is too low, given the substantial hazards facing Exxon's ability to achieve the throughput upon which the rate is based.

Exxon's initial rate has been established in accordance with the principles and practices followed by this Commission, with doubts being resolved in favor of the shipper, rather than the pipeline. In these circumstances, and given the consequences of suspension, a decision by this Commission to suspend would be an abuse of discretion.

III. SUSPENSION OF THE RATES AS FILED WITH LEAVE GIVEN TO REFILE ON A LOWER BASIS OF RATES IS TANTAMOUNT TO A PRESCRIPTION OF RATES WHICH CAN ONLY BE ACCOMPLISHED AFTER "FULL HEARING"

Protestants suggest that suspension of the rates as filed be accompanied by special permission to file on one-days' notice tariffs containing reduced initial rates which the Commission in this suspension proceeding determines should be allowed to take effect and that the *lower,* rather than the filed, rates be encompassed in the Commission's investigation. Such action, if adopted by the Commission, would be beyond the Commission's powers under Section 15(7) of the Act, 49 U.S.C. § 15(7), and would constitute a determination and prescription of rates for the future which can only be done by the Commission after it has held a "full hearing."

Under Section 15(7) the Commission may do certain things in response to the filing of a schedule of new rates: (1) the Commission may investigate the lawfulness of the rates as filed; (2) if the Commission decides to investigate the rates, it may suspend them for a period of up to seven months; (3) if the Commission decides to investigate, but not suspend, it may require the carriers, in the case of increased rates only, to keep accurate account of all amounts received by reason of the increase and to refund any portion (or all) of this increase which the Commission, after investigation, finds to have been unjustified; and (4) the Commission may allow the rates to go into effect without suspension or investigation. Section 15(7) does *not* authorize the Commission as an alternative to a decision as to whether to suspend or not to suspend to make a determination on the basis of protests, oral argument, or on any other basis, that the rates as filed are unreasonable

and should not be allowed to go into effect, but that a lower level of rates is more appropriate and that if tariffs of such lower rates are filed the Commission will not exercise its suspension power. To do so is legally and practically a determination and prescription of rates for the future and is an improper use of the Commission's suspension power. Indeed, Section 15(7) itself provides that it is only after "full hearing" that the Commission "may make such order with reference thereto [i.e., to rates under investigation] as would be proper in a proceeding initiated after it had become effective."

The last quoted language plainly has reference to Section 15(1) of the Act which provides for investigations of existing rates. Section 15(1) authorizes the Commission, if "after full hearing" it finds that an existing rate is unlawful, to "determine and prescribe" a just and reasonable rate.

Thus, under Section 15(1), the Commission may prescribe a rate when it finds the existing rate unlawful, and under Section 15(7) it may prescribe a rate in lieu of a filed rate which the carrier has not justified—but, in either case, the Commission can only do so after it has held a "full hearing."

Moss v. *C.A.B.*, 430 F.2d 891 (D.C. Cir. 1970) clearly shows that the action here proposed by protestants is invalid. In *Moss,* the major air lines filed tariffs of increased domestic fares. In response to those tariffs, the CAB, governed by a statutory framework very similar to that which governs this Commission in rate matters, held oral argument and very shortly thereafter issued an order in which it found that the proposed increased rates may be unjust and unreasonable and that they should be suspended. In that same order the CAB outlined a schedule of lower rates which it believed was reasonable and indicated that

tariffs of such lower rates would not be suspended. A petition for review was filed, principally on the ground that the CAB action was a prescription of rates which was invalid by reason of the agency's failure to observe hearing requirements. The Court of Appeals set aside the CAB order on that ground.[4]

The *Moss* court was not persuaded by the CAB's contentions on appeal, which are also advanced by protestants here (e.g., Bureau Protest, pp. 33-34), that such utilization of the agency's suspension power is proper because the agency is not ordering the carriers to do anything; it is merely suggesting a course of action for the carriers, that the carriers are not legally bound to do anything, and that, if the carriers do file tariffs of the suggested lower rates, it is a "voluntary" act on their part and the resulting rates are carrier-made rates.[5] *Moss* responded to such arguments as follows:

> "The Board did all that it could, short of formally styling its order at rate-making, to induce the carriers to adopt the proposed rates" (430 F.2d at 898).
>
> • • •
>
> "It would seem that upon any realistic interpretation this order involved the legislative determination

4. The Federal Aviation Act authorizes the CAB to determine and prescribe rates "after notice and hearing" (49 U.S.C. § 1482(d)). The Interstate Commerce Act authorizes the Commission to determine and prescribe "after *full* hearing" (49 U.S.C. § § 15(1), 15(7); emphasis added). *A fortiori,* if the agency action in *Moss* did not meet hearing requirements, the action proposed here by protestants would be invalid.

5. Here, the Bureau of Investigations and Enforcement suggests (p. 13) that the Commission include a self-serving statement in its order "that it is not prescribing rates within the meaning of *Arizona Grocery.*"

> of rates by an agency for the future, as described in the Arizona Grocery case" (430 F.2d at 897).[6]

The Bureau of Investigations and Enforcement claims that the proposed action is proper because the Commission in general increase proceedings has "often permitted the refiling on a lower basis pending the proceedings when proposed rates were prima facie unreasonable," citing (p. 13) Ex Parte No. 259, *Increased Freight Rates,* 1969, 332 I.C.C. 590 (1968). It also cites (p. 34) as support for what it characterizes as a "conditional no-suspend order" the Commission's action in Ex Parte No. 305, *Nationwide Increase of Ten Percent In Freight Rates and Charges,* 1974, sustained in *United States* v. *Chesapeake & Ohio R. Co.,* 426 U.S. 500 (1976).

The Commission's action in Ex Parte No. 305 provides no support for the action proposed here. There, the railroads applied for a ten percent general increase in their rates and charges. The railroads conceded that the proposed increase could be justified on the basis of increases in operating expenses only to the extent of three percent, but represented to the Commission that the balance (seven percent) of the increase was required in order to make up for the deferral of maintenance and other necessary capital expenditures. The Commission suspended the ten-

6. In *Moss,* the order did provide that the CAB "intend[ed] to consider fares produced by [its] formula as a 'just and reasonable' ceiling" (430 F.2d at 896). However, it would not seem that the elimination of that language would make the agency's action any less a prescription of maximum reasonable rates. As the *Moss* court noted:

> "As a *practical* matter, the Board's order amounted to the prescription of rates because, as the Board admits, the pressures on the carriers to file rates conforming exactly with the Board's formula was great, if not actually irresistible" (430 F.2d at 897; emphasis added).

percent increase, but granted the carriers leave to refile for a ten percent increase specifically conditioned on *use* of the revenues derived from that portion of the increase over and above the amount needed, up to three percent, for increased materials and supply costs (other than fuel) to reduce deferred maintenance of plant and equipment and delayed capital improvements. The Commission's order was upheld by the Supreme Court as "a legitimate, reasonable and direct adjustment to the Commission's explicit statutory power to suspend rates pending investigation." *United States* v. *Chesapeake & Ohio R. Co.,* 426 U.S. 500, 514 (1976).

The conditional suspension order in Ex Parte No. 305 is no support for the kind of order proposed here. The inquiry into the validity of the Ex Parte No. 305 order was essentially a test of whether the Commission could intrude upon management decisions with respect to the expenditure of carrier funds. The Supreme Court decided in the context of that proceeding that the Commission could, because it "specified no particular projects" and, more importantly, because the railroads had represented to the Commission that the increase could only be justified by their needs in respect of maintenance and capital deferrals—the "Commission simply held the railroads to their representation" (426 U.S. at 515). That decision has no relevance here, where it is proposed that the Commission suspend new rates which the carriers have determined to be just and reasonable, giving them the alternative of either having no rate in effect, in which case they cannot engage in transportation, or accepting a level of rates which the Commission, without any hearing whatsoever, has arbitrarily decided is appropriate.

Similarly, it is no answer to suggest, as the Bureau does, that the Commission has suspended the increased rates as

filed in general increase proceedings and permitted the refiling of rates on a lower basis. Suffice it to say that the "we suspend these rates, but won't suspend rates filed as we determine them" order condemned in *Moss* was made in the context of a general increase proceeding in which the agency deemed the increase proposal prima facie unreasonable. More importantly, however, there is a critical distinction which must be recognized between the filing of a general increase in existing rates and the filing of an initial rate to be made applicable to an entirely new movement. In a general increase proceeding, the carriers seek a permissive order authorizing them, based upon increases in operating costs, to apply an across-the-board increase in their rates. Suspension of such a tariff filing, or suspension with leave to refile for a lesser increase (assuming the validity of that action), while having very serious consequences for the carriers' net operating results, does leave the carriers in the posture of continuing to generate revenue on the basis of either the existing, or slightly increased, rates. In contrast, the suspension of a new rate, or suspension of a new rate with leave to refile on a lower basis, can have a devastating impact upon the involved carriers, particularly where large capital expenditures have been involved in the development and construction of the transportation service to which the rate is to apply. In that situation, the carriers are forced either to suffer the catastrophic consequence of having their newly-constructed facilities remain idle or to accept "voluntarily" rates which the Commission, in a back-room exercise of arbitrary power, has determined to be acceptable in order that their investment will generate some revenue.

In *Moss,* the court considered the pressures on the carriers to accept the lesser general increase "suggested" by

the CAB to be "irresistible." It does not require elaborate argument to conclude that the pressures on the TAPS carriers which would be created by an order along the lines proposed by protestants are enormous. Simply stated, the proposed exercise of the Commission's suspension power to coerce the adoption of a lower rate is a heavy club which no regulatory agency should be permitted to have, and which this Commission does not have.

IV. The Bureau's Proposed Rates Do Not Conform To Established Commission Precedent

The Bureau of Investigations and Enforcement is the only protestant that even purports to sponsor proposed rates which reflect any aspect of the Commission's conventional approach to measuring the reasonableness of pipeline rates. The Bureau's rates, like the rate proposed by Exxon, are based on valuation, as has historically been the case since the Commission assumed jurisdiction over pipelines. Any differences between the valuation employed by the Bureau and that employed by Exxon are minor.

The Bureau and Exxon also agree that, for the purposes of these suspension proceedings, the Commission should accept Exxon's figures for operating costs, daily throughput, and the original cost used in determining rate base, and that taxes should be normalized.

Apart from the foregoing discussion of the lack of any authority in the Commission to condition the suspension of a rate on the filing of a lower rate, the areas of disagreement between the Bureau and Exxon, which produce a rate of $6.27 under Exxon's approach and a rate of $5.00 under that of the Bureau, although extremely significant are relatively few. These issues can be summarized as follows:

1. The Bureau assumes a useful life for TAPS of 27.5 years, while Exxon employs a life of 25 years.

2. The Bureau assumes both that the amounts included in cost of service to cover removal and restoration costs will be tax free and will ultimately be deductible for Alaskan income tax when expended. The Bureau also contends that the liability to incur such costs is contingent, rather than fixed. In both respects, the Bureau is wrong.

3. Exxon and the Bureau disagree on the treatment of interest in calculating return on valuation. Exxon treats interest as an expense, while the Bureau does not, contending that interest should be included in return.

4. The Bureau, using its preferred method of calculating return, allows a rate of return of only 10%. It is Exxon's position that, if the Bureau's method were to be adopted, such a rate of return is clearly inadequate.

The State of Alaska has also submitted a rate calculation for Sohio only using the method adopted by the Bureau, although it does not advocate its adoption. In principle, Alaska's computation suffers from the same defects as the Bureau's in treating interest improperly, and, accordingly is not treated separately.

A. Depreciation

With respect to depreciation, the Bureau cites sources reflecting estimates of useful life for the existing Alaskan fields ranging from 25 to 35 years.[7] It then advocates adoption of the average of the FPC range, asserting that 27.5 years is somehow "more reasonable" than 25 years.

7. FPC—25 to 30 years; El Paso Alaska—28 years; FEA—26.5 years; Wainwright Securities, Inc.—35 years.

In taking this position, the Bureau makes no independent analysis. More importantly, it ignores the fact that the FPC estimate dealt with the physical life of the *field,* and did not encompass the question of the useful economic life of the pipeline. It may well be, and indeed is probable, that the field will still be physically capable of producing some oil economically (in terms of production costs) well after it has become uneconomic to transport that oil through the pipeline because of inadequate throughput.

As Exxon advised the Commission's Bureau of Accounts on April 27, 1977, it is Exxon's position that the TAPS facilities should be depreciated over that period during which an owner can expect to earn a fair return, based upon ICC valuation, giving proper consideration to the high level of risk inherent in the construction and operation of TAPS. Making a precise estimate of this period is extremely difficult in the case of TAPS since the U.S. pipeline industry has no experience in operating a pipeline of the design, or in an environment, like that of TAPS. Furthermore, the economic life of the pipeline is determined not only by the amount of throughput, but also by the relation of throughput to (1) the level of pipeline operating and maintenance expense in a totally new and radically difficult environment for a pipeline that is subject to vigorous government specifications and oversight, (2) the impact of inflation on those costs and expenses, and (3) the maximum tariff rates that this Commission will approve and that shippers will pay in light of their own operating expenses and the prices being paid or permitted for crude oil in the connected fields. Based on its best judgment, and all of its experience, it is Exxon's belief that a fair return can no longer earned when throughput declines to 200-300 thousand barrels per day. The so-called Mortada Study upon which the Bureau relies (when it suits

its convenience) estimates that by the 25th year, throughput will be reduced to 240,000 barrels per day, and would continue to decline. For this reason, Exxon estimates that the reasonable maximum estimate of TAPS useful life, at this time, is 25 years.

There is, of course, no guarantee that a useful life that long can be achieved. The actions of this Commission, price changes by the OPEC members, lack of transportation facilities in the lower-48 states, physical calamities, increasing inflation, and many other presently unknown factors may drastically shorten that period. If it does, Exxon and the other TAPS owners bear the risk. On the other hand, if experience should indicate that the 25-year life is too conservative, the depreciation rate can be adjusted. It makes no sense whatsoever either to fix a depreciation rate now on the basis of undiscovered oil, as certain protestants contend should be done, or to adopt the most optimistic estimates of the pipeline's useful life.

While the Bureau has labelled Exxon's use of a 25-year life as "conservative", it has not, and could not, assert that use of a 25-year life is unreasonable. Exxon has clearly shown a rational basis for its use of a 25-year life for TAPS. The Bureau's arbitrary selection of a 27.5 year life as "more reasonable", based on averaging an irrelevant estimate should be rejected.

B. Removal And Restoration Costs

Exxon has included an amount of $16.4 million per year in its expenses to reflect its unconditional obligation to bear its proportionate share of the cost of removing all above-ground TAPS facilities and restoring the land to a condition satisfactory to the Department of Interior at the end of the pipeline's useful life.

The Bureau questions this expense, contending that the liability is qualified rather than fixed. The Bureau bases this contention on the terms of Paragraph 13A of the Agreement and Grant of Right of Way, dated January 23, 1974, between the Department of Interior and the carriers. Paragraph 13A, however, applies to damages *during use.* The obligations to remove and restore *on completion of use* are found, not in paragraph 13A, but in Stiulpation 1.10.1 of Exhibit D to that Agreement. Stipulation 1.10.1 unconditionally obligates the carriers to remove and restore all above ground facilities on completion of use:

> "1.10 Completion of Use
>
> 1.10.1 Upon completion of the use of all, of a very substantial part, of the Right-of-Way or other portion of the Pipeline System, Permittees shall promptly remove all improvements and equipment, except as otherwise approved in writing by the Authorized Officer, and shall restore the land to a condition that is satisfactory to the Authorized Officer or at the option of Permittees pay the cost of such removal and restoration. The satisfaction of the Authorized Officer shall be stated in writing. Where approved in writing by the Authorized Officer, buried pipe may be left in place, provided all oil and residue are removed from the pipe and the ends are suitably capped."

The Bureau next challenges the amount included in its rate by Exxon to provide the funds necessary for this work, reducing this expense from $16.4 million to $7.6 million (Bureau Protest, App. A, pp. 1,2). This difference arises from the following differences of approach:

Exxon, in computing these costs maintains that a sum of money should be collected annually after-tax, which when

reinvested will earn the amount which, added to the principal, will be the amount required to perform the required work in 2002, when restoration and removal commence. In determining its requirements, Exxon has assumed that both the rate of escalation of costs over the 25 year period and the rate which it can earn on the after-tax amounts invested will be 6% also after taxes. Thus, of the $16.4 million which Exxon proposes to collect each year, it will have $8.5 million available to invest after taxes, which will accumulate to $466 million by the year 2002. Of this amount only $212.5 million will have been collected from shippers. The accumulated fund of $466 million represents slightly less than the present estimate of Exxon Pipeline's share of the restoration and removal costs, after giving effect to the tax consequences of these expenditures.

The Bureau, on the other hand, simplistically takes the estimated costs of restoration and removal in 1977 dollars and divides by 27.5 years, making no allowance for the taxability of these payments when received. Under the Bureau's approach, Exxon would have available for investment purposes only $3.58 million per year. Investing that sum at 6% for 27.5 years would produce a total of only about $236.6 million in 2005, or $229.4 million less than Exxon will require. Indeed, based on Exxon's share of these costs in 1977 dollars, the Bureau allows for only a cumulative inflation rate of less than 12% over a 27.5 year period, reflecting an average annual inflation rate only of 0.44%. This defies all experience.

The only way the Bureau could justify its approach would be to amend the tax laws of the United States and Alaska, not only to make the receipt of these funds tax-free, but also to provide, in the case of Alaska, for a tax deduction at a time when there is no Alaskan income against

which to offset the expense. In addition, the Bureau would have to convince the Commission that there will be virtually no inflation over the next 27.5 years.

Exxon's treatment of the removal and restoration costs is realistic, yet conservative. Exxon has, for example, assumed that the Department of Interior will not require the removal of *any* underground facilities. If Interior were to require the removal of all such facilities, the total costs of removal and restoration would triple. The future attitude of that Department with respect to the removal of such facilities is also a risk borne by Exxon and by the other owners of TAPS.

C. The Treatment of Interest In Calculating Return

In calculating its return on valuation, Exxon has followed the traditional practice of treating interest as an expense. On this basis, Exxon's return on valuation under its $6.27 rate for the year 1978 would be 6.5% with total TAPS throughput at 1.2 million barrels per day. By contrast, the returns produced by the rates proposed by the Bureau, the Department of Justice, and Alaska would be 3.8%, 1.9%, and 1.31%, respectively. If as noted above, the throughput volume falls by only 5%, Exxon's return becomes 5.8% at the $6.27 rate, and 3.3%, 1.7%, and 1.1% at the rates proposed by the Bureau, the Department of Justice, and Alaska.

The Bureau attempts to avoid the implications of the miniscule returns resulting from the lower rates proposed by protestants by arguing that, contrary to existing practice, interest should not be treated as an expense, but should, instead, be recovered in the return element of the rate.

The Bureau attempts to defend this approach primarily by relying on a comparison of certain 1935 figures set forth in *Reduced Pipe Line Rates and Gathering Charges,* 243 I.C.C. 115 (1940) with the figures shown in Transport Statistics, 1935, p. S-61, contending that these sources demonstrate that "the long-standing practice of the Commission in fact has been to include interest as an element of the return on valuation for pipelines" (Bureau Protest, p. 29).

While Exxon, which had no interest expense in 1935, cannot evaluate the Bureau's claims as to the practice in 1935 from its own records, it should be noted that its statement covers only 9 of the 35 pipelines listed in Appendix D of the Report in *Reduced Pipe Line Rates and Gathering Charges* (243 I.C.C. at 148), and that there were other pipelines in operation at that time which were not listed in Appendix D.

It should also be noted that in a very recent administrative construction of the *Reduced Pipe Line Rates* case, in ICC Docket No. 36352, *Petroleum Crude Oil, Griffith, Ind. to New York Points,* (October 14, 1976) involving the rates charged by Lakehead Pipe Line Company, the Administrative Law Judge took a position directly contrary to that of the Bureau stating:

> "As a result of these large volumes, at the through rates, the return on valuation (after interest expense is deducted) for both Lakehead and IPL is approximately 6 to 7 percent. • • • (Initial Decision, pp. 6-7).
>
> ". . . the standard used by Lakehead, i.e., allowing a 6 to 7 percent return on I.C.C. valuation [after deducting interest as an expense] in establishing the rate at issue is below that utilized heretofore by the Commission for crude oil pipelines in *Reduced Pipe*

> *Line Rates and Gathering Charles* 243 I.C.C. 115, 143 (1940) . . ." (*Id.* at p. 9).

This is at least a clear recognition that the practice of determining rate of return by treating interest as an expense, as Exxon has done, is common practice before this Commission.

The dangers of relying on the Bureau as a source of information as to what constitutes the Commission's usual practice with respect to pipeline ratemaking is clearly illustrated by its treatment of the decision in *Petroleum Products, William Brothers Pipe Line Company,* ICC Docket No. 35533, cited at page 27 of its Protest. The Bureau brushes off the *William Bros.* decision as the *only* "reported pipeline rate case that awards the entire return on valuation to the equity holders of the pipeline" (Bureau Protest, p. 27). In fact, the *William Bros.* decision is the *only* reported pipeline case which explicity treats interest as the Bureau contends it should be treated. Exxon does agree with the Bureau, however, that the *William Bros.* case is an anomaly. Moreover, in that proceeding, it made no practical difference to the pipeline which method was employed, since its rates were clearly reasonable under either method.

Contrary to the Bureau's position, if the practice in 1935 was as the Bureau contends, that practice was not "long-standing". The Commission itself has represented to the Congress as recently as March 22, 1976, that the standard methodology utilized in computing return on valuation for oil pipelines is to treat interest as an expense. In 1975 and 1976, responding to a questionnaire from the Subcommittee on Activities of Regulatory Agencies of the Committee on Small Business of the House of Representatives, the then Chairman of the Commission, George M. Stafford, supplied

the Subcommittee with a calculation of the rates of return on valuation for 90 regular pipelines for the years 1970 through 1972 (see Appendix B). A comparison of the Exxon data submitted by the Commission in this report with company records, together with checks on data for certain other pipelines, clearly shows that in calculating those rates of return, the Commission treated interest as an expense, as Exxon contends it should be treated. This data was submitted as a result of the questioning of Chairman Stafford, accompanied by Commissioner Murphy, Legislative Counsel Knappen, Deputy General Counsel Cerra, Counsel to the Chairman Ketchan, at hearings held on October 2, 1975, set forth in "Regulations of Various Federal Regulatory Agencies and Their Effect on Small Business" (Part 2) (the "Hungate Report"), commencing at page 890, in response to questions concerning pipeline returns.

This is hardly surprising, since other evidence shows that the Commission, as well as other concerned governmental bodies, have clearly understood that the Commission's standard practice has been to treat interest as an expense in determining rate of return on valuation.

In 1941, when the Department of Justice entered into the consent decree in *United States* v. *Atlantic Refining Co.*, C.A. No. 14060, D.D.C., it imposed a limitation on the dividend payments which could be made by subsidiary pipelines to their parents. The limitation prescribed by the decree prohibits the payment of dividends in excess of 7% of ICC valuation. The return is thus computed pursuant to the following formula:

$$\frac{\text{Net Income (After Tax)}}{\text{ICC Valuation}}$$

Clearly, net income after tax does not include interest as a component of return.

As former Attorney General Edward H. Levi advised the Department of Transportation on November 5, 1976, in connection with the LOOP and SEADOCK projects, "The consent decree was intended to hold down rates through its limitation on the rate of return".[8] If, as the Bureau contends, the Commission had been calculating return on the basis the Bureau now advocates, the consent decree would have offered no assurance that it would accomplish this purpose. Given any fixed set of operating results, valuation, and debt/equity ratio the funds available for payment of dividends will always be *less* under the Bureau's method of determining return than the dividend limitation imposed by the consent decree, except where the debt component of the capital structure is equal to or less than $\frac{.01}{i} \times V$, where i is the debt interest rate and V the valuation. Accordingly, any increase in debt with no change in interest rate, or any increase in interest rates with no change in debt, beyond that level would eliminate any impact of the Consent Decree, making the Bureau's proposed method of calculating return the constraint on rates.

Attorney General Levi's presentation in the LOOP and SEADOCK antitrust review demonstrates even though both debt/equity ratios and interest rates have risen markedly since 1941, that Consent Decree has in fact, continued to be the constraint on rates. Criticizing "the way in which both the ICC and the Consent Decree compute allowable returns," he stated ". . . in computing the net income figure, the ICC does not include interest payments (net of tax benefits) that constitute the return to the debt-

8. Report of the Attorney General Pursuant to Section 7 of the Deepwater Port Act of 1974 on the Applications of LOOP, Inc. and SEADOCK, Inc. For Deepwater Port Licenses, Nov. 5, 1976 ("A.G. Report"), p. 62.

supported assets of the rate base" (A.G. Report, p. 62). In concluding his discussion of tariff rates and charges, he stated, "In sum, for ICC-regulated pipelines, the ICC allows greater returns than those permitted under the Consent Decree . . ." (Cite p. 64).

Plainly, in 1941, the Department of Justice understood that the ICC did not treat interest as the Bureau contends it did in 1935, and it has continued for over 35 years to understand that the Commission's practice is the same as that prescribed in the Consent Decree.

The Federal Power Commission's Recommendation to the President on Alaska Natural Gas Transportation Systems, issued May 1, 1977, selectively quoted by the Bureau, is further evidence of the general knowledge that, in calculating return, this Commission has treated interest as an expense. As the Bureau has acknowledged, the FPC referred to "the usual ICC treatment of allowing a 7-8 percent rate of return *after taxes and interest* on ICC valuation (i.e., total assets)," precisely as Exxon contends it has done (Recommendation, p. XII-45; emphasis in original).

Furthermore, far from refusing to accept as reasonable the rate of return of 28-32% on equity, based on a debt/equity radio of 75-25, which the FPC estimated would result for TAPS from the ICC methodology, the FPC adopted a 23% overall rate of return as reasonable for an Alaskan gas pipeline. Given a 75/25 debt/equity ratio, this overall rate of return results in a 31% after-tax return on equity (*Id.* at pp. XII-46-XII-48). The FPC stated:

> "Such after-tax returns on equity are in line with the returns petroleum companies currently earn on their integrated operations, and will likely earn on the Alaskan oil pipeline *if comparable D/E ratios are assumed*" (Recommendation, pp. XII-47-XII-48; emphasi in original).

As the FPC stated with respect to the Alaskan gas pipeline, which it deemed to be comparable in size and complexity with TAPS (*id.* at XII-45):

> ". . . we cannot reasonably expect that such [petroleum] companies will risk billions of dollars on this project unless they have the *opportunity* to earn returns similar to those that they average on alternate projects" (*id.* at XII-46; emphasis in original).

The Bureau has wholly failed, as it must, to present any convincing evidence that at any time in the last 35 years, at least, the usual practice in calculating pipeline rates of return on valuation has not been to treat interest as an expense. The Bureau is perfectly free to argue that the method it advocates should be adopted, but not in these suspension proceedings. Such arguments properly belong in Ex Parte No. 308, where the Commission is already considering the issue of the general standards governing rate of return for oil pipelines.

D. Rate of Return Under the Bureau's Method

Assuming for purposes of discussion that the Bureau's method of calculating return is to be followed, the Bureau has already recognized in its Protest that the Commission's general guidelines for rate of return on valuation for oil pipelines, adopted in 1941, are not binding in an individual pipeline rate proceeding (see Bureau Protest, pp. 17-18). Recognizing that an automatic application of the 8% rate of return historically viewed as a general standard for crude oil pipelines would be grossly unjust as applied to TAPS, the Bureau recommends a return of 10 percent, historically applied to products lines, and not to crude lines. Exxon while it agrees with the Bureau that the rate of re-

turn on valuation must be tailored to the circumstances of a particular pipeline project in a specific rate proceeding, does not agree that 10% is adequate, assuming that the Bureau's method of calculating return is accepted. The mere fact that it was deemed a reasonable rate for products lines in the lower-48 states in 1941, certainly does not make it a reasonable rate for TAPS in 1977.

In Ex Parte No. 308, the Association of Oil Pipelines, acting on behalf of Exxon and many of its other members, filed testimony by Raymond B. Gary, a Managing Director of Morgan Stanley & Co., and Dr. Ezra Solomon, Dean Witter Professor of Finance at the Graduate School of Business of Stanford University, copies of which are submitted herewith as Appendixes C and D. These two witnesses, each a recognized expert in the field of finance, have employed different techniques to determine the minimum overall rate of return on valuation required for a relatively low risk oil pipeline, recognizing that these returns would not be sufficient for pipelines with above average riskiness. Mr. Gary concluded, on the basis of his market analysis, that 13-14% was minimum return on total valuation for an oil pipeline today. Dr. Solomon, comparing the relative risk of oil pipeline with that of Aaa corporate bonds, concluded that a return on total valuation of 13 to 13½ percent was appropriate for pipelines of minimum risk.

Since both Mr. Gary and Dr. Solomon dealt with total valuation, without considering the division of the capital employed into debt and equity components, their conclusions with respect to an overall rate of return can be directly compared with the Bureau's proposed 10% return.

On the basis of the analyses made by Mr. Gary and Dr. Solomon, it is clear that, if a 13-14% rate of return on total valuation is the minimum for a low-risk pipeline, a 10% return for one of the riskiest pipeline ventures ever under-

taken is grossly inadequate. The degree of inadequacy is indicated by the FPC's approval of a 23% overall rate of return for an Alaskan gas transportation system serving the same fields as those served by TAPS.

In setting its $6.27 rate, however, Exxon did not attempt to arrive at an overall rate of return based either on the market requirements considered by Mr. Gary or on the comparative risks considered by Dr. Solomon or on the risks peculiar to the TAPS project. Instead, Exxon established a rate in the same manner it has employed for conventional pipeline projects in the lower-48 states. Utilizing the Bureau's method of calculating return on valuation, *excluding interest as an expense,* the $6.27 rate results in an overall return of only 12.25%, *less* than the minimum return required for a minimum risk pipeline.

It is apparent that even if this Commission should depart from its settled practices and abrogate its decisions that matters of methodology which affect all pipelines are to be resolved in rulemaking proceedings and not in individual pipeline rate cases, Exxon's proposed $6.27 rate is just and reasonable, even when tested by the Bureau's method.

V. The Proposals of the State of Alaska and of the Department of Justice that the Commission Establish New Standards for Evaluating the Reasonableness of Pipeline Rates Should Not Be Considered in This Proceeding

A. The Commission Is Required By Statute To Determine The Valuation Of Oil Pipeline Property And Use That Valuation As The Rate Base

In its protest, the State of Alaska states that it "opposes the use of the Commission's 'valuation' as a rate base," asserting that the valuation rate base is inflationary

and precludes meaningful comparable earnings analysis. (Alaska Protest, p. 40). The Department of Justice without explicitly attacking the Commission's traditional valuation approach (or indeed, acknowledging its existence), also appears to advocate radically new standards for pipeline ratemaking. To the extent that these protestants suggest that the Commission employ some method for analyzing the joint owners' tariff schedules other than the required valuation approach, their protests should be ignored.

Section 19a of the Interstate Commerce Act, 49 U.S.C. § 19a, imposes upon the Commission the duty of determining the valuation of oil pipeline property. That section directs the Commission to ascertain for property used for common carrier purposes "the original cost to date, the cost of reproduction new, the cost of reproduction less depreciation," and other elements of value of such properties (49 U.S.C. § 19a(b)). Based upon these data, the Commission is directed to determine "the value of the property of every common carrier as a whole . . ." (49 U.S.C. §19a(c)). Section 19a provides that the final valuation determined by the Commission "shall be published and shall be prima facie evidence of the value of the property in all proceedings under [Chapter 1 of the Act] . . ." (49 U.S.C. § 19a(i)).

Plainly, the Commission's present method of determining the reasonableness of pipeline rates has been established by Congress, and Congress' intention that the present methods be continued was recently confirmed when, in adopting radical changes in the methods of establishing railroad rates, Congress elected to make no change in either Sections 15(7) or 19a as applied to pipelines. Reporting on the legislation which evolved into the Railroad Revitalization and Regulatory Reform Act of 1976, creating the

new standards of ratemaking for railroads, the House Committee on Interstate and Foreign Commerce stated:

> "The Committee has not included oil pipelines in it [i.e., the new standards of ratemaking], since there does not, at the present time, appear to be a need to do so. Under Part I of the Interstate Commerce Act the tariff rates of interstate common carrier oil pipelines are subject to ICC regulation to the same extent as those of railroads. Historically, in determining the reasonableness of the rates of an oil pipeline, the ICC has based such determination upon the annual valuation of the pipeline established by the Commission. Included in the formula used by the Commission in establishing annual valuations of pipeline companies is a factor reflecting the reproduction cost-new of the pipeline system, less depreciation. The use by the ICC of the annual valuation of the pipeline in determining the reasonableness of its rates has permitted the industry to generate common carrier revenues and earnings adequate to engender substantial capital investment in, and needed expansion of, the nation's oil pipeline network." H.R. Report No. 93-1381, 93d Cong., 2d Sess. p. 26, n. 1 (1974).

These protestants' attempts to have the Commission view the joint owners' filed rates from any viewpoint other than a valuation rate base, as required by statute, should be rejected.

B. The Protestants' Questions Concerning The Commission's Valuation Methodology Cannot Be Raised In A Suspension Or Rate Proceeding

Both the State of Alaska and the Department of Justice reject the Commission's established practice of reviewing

the reasonableness of rates by measuring them against return on valuation and both protestants engage in a debt/equity analysis of individual owners, extrapolating from partial cost and revenue figures and removing from the normal valuation base figures which they find objectionable. (*See* Alaska Protest, pp. 40-44; DOJ Protest, pp. 2-8, Exhibits I and II) In doing so, the protestants seek to inject improperly in this suspension proceeding issues involving valuation procedures and methodology, issues which can be dealt with only in a rule-making proceeding.

The framers of the Interstate Commerce Act clearly intended to keep rate proceedings separate and distinct from valuation proceedings. They also contemplated that the methodology used in valuation proceedings would be determined by rules and regulations, properly proposed and examined in rule-making proceedings pursuant to the Administrative Procedure Act (APA), 5 U.S.C. §§551 *et seq.*, before becoming effective. They certainly did not intend that the Commission use a different valuation methodology for each different pipeline carrier, nor did they intend that the Commission's valuation methodology be established or modified in the context of a carrier-initiated rate filing.

The Commission has in fact initiated a rule-making proceeding that encompasses the methodology used for pipeline valuation. In that proceeding, Ex Parte No. 308, *Valuation of Common Carrier Pipe Lines,* described more fully below, the Commission is dealing with the kinds of issues raised by some of the protestants. These protestants' concerns with regard to valuation should be focused on that rule-making proceeding and not on this suspension proceeding.

Ex Parte No. 308 was instituted on September 3, 1974, when the Commission served a "Notice of Proposed Rulemaking and Order" in which it stated that,

> ". . . a proceeding be, and it is hereby, instituted under part I of the Interstate Commerce Act (49 U.S.C. Sec. 1), including section 19a thereof, relating to valuation of common-carrier property, and pursuant to sections 553 and 554 of the Administrative Procedure Act (5 U.S.C. secs. 553 and 554), for the purpose of determining whether any modification is required in the rules and regulations contained in part 1204 of Title 49 of the Code of Federal Regulations, entitled 'Pipeline Companies, List of Institution and Accounts,' in part 1260 of said Title 49, entitled 'Reporting of Data for Initial Pipeline Valuations,' and in part 1261 of said Title 49, entitled "Regulations Governing the Reporting of Property Changes; Pipeline Carriers" or any modification in the methodology of valuation stated in *Ajax Pipe Line Corporation,* 50 Val. Rep. 1."

The Notice of Proposed Rulemaking was issued not long after the Initial Decision in Docket No. 35533, *Petroleum Products, Williams Brothers Pipe Line Company,* a decision in which the presiding judge discussed valuation and pipeline ratemaking extensively and rejected shippers' objections to the Commission's valuation process (see below). Ex Parte No. 308 was initially consolidated with Valuation Docket No. 1423, *Williams Brothers Pipe Line Company,* in which protests had raised issues concerning the Commission's valuation process, including the methodology employed. Shortly thereafter, however, the Commission apparently recognized the impropriety of consolidating a

rulemaking proceeding and a valuation proceeding and, on December 16, 1974, issued a "Supplemental Notice of Proposed Rulemaking and Order" in which it: (1) severed Valuation Docket No. 1423 from Ex Parte No. 308; (2) stated that consideration of pipeline valuation methodologies is the proper subject of, and will be considered in, Ex Parte No. 308; and (3) ordered that Valuation Docket No. 1423 be governed by the Commission's existing rules and regulations regarding valuation. From that point, Ex Parte No. 308 proceeded as would any rulemaking proceeding. On December 18, 1975, the Commission issued another "Supplemental Notice of Proposed Rulemaking and Order," broadening the proceeding to include an examination, on an industry-wide basis, of the proper rate of return for crude petroleum and petroleum products pipelines.[9] Statements of views and data have been filed by the various parties in Ex Parte No. 308 and a hearing is scheduled for August 16, 1977, for the purpose of cross-examining witnesses.

It is very clear that the issues concerning valuation methodology raised by the State of Alaska and the Department of Justice are encompassed by Ex Parte No. 308 and that, accordingly, those issues should not be encompassed by this or any other rate proceeding. The Commission recently recognized the impropriety and wastefulness of trying to interject issues involving valuation methodology in a pipeline rate proceeding. In *Petroleum Products, Williams Brothers Pipe Line Company,* Docket No. 35533, *supra,* a proceeding involving carrier-initiated increased pipeline rates and initial joint rates, various complaining parties attacked the reasonableness of the rates and attacked the use of the Commission's valuation as a rate

9. Obviously, the generalized determinations to be reached in Ex Parte No. 308 on rate of return will not be controlling in particular rate cases.

base, asserting that the valuation procedures were objectionable in a number of respects. The complainants opposed the inclusion of certain property in the valuation rate base, the weight given certain costs in the valuation formula, and the rate of return adopted by the Commission as a reasonable guideline for petroleum pipelines.

The presiding judge found the proposed increased rates just and reasonable and the proposed initial joint rates not unlawful (Initial Decision, June 19, 1974). In doing so, he wrote (p. 18):

> ". . . The matter of defects in the Commission's valuation process raised by the Shipper Group has no place here. The valuation process pursuant to section 19a has been employed by the Commission for many years and on railroad and pipeline valuations has withstood many challenges. Any questions involving the valuation process should be determined in a rulemaking proceeding at which all affected persons are allowed to present their views."

Upon exceptions of various shippers, the ultimate conclusions of the Administrative Law Judge were adopted by Division 2 (351 I.C.C. 102, November 5, 1975). In commenting upon the shippers' exceptions regarding valuation methodology, Division 2 noted that (351 I.C.C. at 112):

> "In Ex Parte No. 308, the Commission will address itself to each of the seven elements it considers in the development of a valuation. These are (1) original cost, (2) cost of reproduction new, (3) cost of reproduction new less depreciation, (4) going concern value, (5) present value of land, (6) present value of rights-of-way, and (7) working capital. Since the Commission applies the same procedures

> equally to all pipeline carriers under its jurisdiction, there is no reason to single out one carrier and apply different procedures. If the Commission should elect to change its methodology of performing valuations in Ex Parte No. 308, the new methodology will be applied to all carriers equally and on the same basis."

On reconsideration, the Commission essentially affirmed the ultimate conclusions reached by Division 2 and the presiding judge and stated the following, pertinent to the protests in this proceeding (Report Of The Commission On Reconsideration, December 3, 1976, pp. 6, 7, 8):[10]

> ". . . Questions have been raised in this proceeding both as to whether the carrier's valuation is the proper rate base, and as to what rate of return should be permitted.
>
> • • •
>
> "We conclude that the Commission's valuation of WBPL's properties is the proper rate base to be employed in this proceeding . . . Considerations of consistency and fairness require that we adhere to our previously recognized criteria in investigating the rates of particular pipelines at the present time . . . .
>
> • • •
>
> "The technique employed by the Commission in making its valuations was discussed in the Division's report. As the Division found, this is not the proceeding for considering a change in the valuation

10. The Commission's decision is Docket No. 35533 is currently on appeal in the Circuit Court of Appeals for the District of Columbia *sub nom. Farmers' Union Central Exch., et al.* v. *ICC*, No. 76-2138.

> methods. Such questions will be dealt with in the pending rulemaking proceeding in Ex Parte No. 308, *Valuation of Common Carrier Pipelines.*"[11]

While the Commission was considering Division 2's conclusions in Docket No. 35533, a similar conclusion with regard to raising issues of valuation methodology in rate proceedings was reached by the Presiding Judge in another Williams Brothers Pipe Line Company rate increase proceeding, I & S Docket No. 9089 (July 27, 1976, p. 18):

> "A valuation rate base, determined upon the basic concepts of the Commission, is the proper base for use in determining rate of return for net carrier earnings of pipelines. To establish a rate of return on any basis other than that previously accepted by the Commission . . . presupposes the Commission's decision in Ex Parte No. 308, *Valuation of Common Carrier Pipelines.* Therefore it follows that in the instant general increase, reasonableness of rates must be based upon rate of return computed by applying total net carrier revenues, less an amount for Federal Income Taxes, against a valuation rate base . . . ."

These excerpts from the Commission's and the presiding judges' decisions in Docket No. 35533 and I & S Docket No. 9089 clearly show that the questions raised by the protest-

11. The Commission also noted that Division 2 had recommended that the scope of the proceeding in Ex Parte No. 308 be broadened to include consideration of the rate of return question. As noted previously, Ex Parte No. 308 was so expanded by Commission order of December 18, 1975, to "include an examination of what is the proper rate of return for crude petroleum and petroleum products." That examination is taking place, of course, on an industry-wide basis, leaving individual rates of return for individual pipe line carriers to be determined in individual rate proceedings.

ants concerning the use of valuation methodology should be removed from consideration in this suspension proceeding since they are the focal issues in Ex Parte No. 308. To attempt to deal with those issues here would be: (1) violative of the statutory scheme separating specific rate-making, general rulemaking, and valuation; (2) unfair to the joint owners of TAPS who have assumed that the existing valuation methodology will apply until modified in a proper rulemaking proceeding such as Ex Parte No. 308; and (3) wasteful of the Commission's and the parties' time since those issues are already undergoing extensive study in Ex Parte No. 308.

In sum, the process submitted herein, insofar as they raise questions of valuation methodology, are improper and should be summarily rejected.

Similarly the protestants' assertions that the original cost of TAPS may be overstated, based on allegations of waste and mismanagement, cannot be dealt with in this suspension proceeding, as the protestants expressly or impliedly concede. Indeed, given the fact that none of the protestants actually attempt to use these allegations in their alternate rate proposals, it seems fair to assume that the attention they give to these matters at this stage is intended simply to divert the Commission from the task at hand and to establish a prejudicial climate in which the Commission is to make its decision with respect to the exercise of its suspension power. To the extent such charges are reasserted in the statutory valuation proceeding which this Commission must undertake, all questions relating to reasonableness of the costs actually incurred in constructing TAPS can be resolved and appropriate action taken

thereafter. Suffice it to say at this point that Exxon is confident that when all of the facts are before the Commission it will be found that those costs were reasonable, given the magnitude of this project, the adverse conditions under which it was constructed, and the constraints imposed by both the State and Federal governments to protect the environment.

At this stage of these proceedings, it is clear that these allegations must be put to one side until resolved after a full hearing. In *West Ohio Gas Co.* v. *Public Utilities Com.*, 294 U.S. 63 (1935), the Supreme Court, dealing with a constitutional challenge that the rates of a gas distribution company were confiscatory in that they provided an inadequate return on valuation because of the exclusion of certain expenses as wasteful or negligently incurred, stated:

> "A public utility will not be permitted to include negligent or wasteful losses among its operating charges. The waste or negligence, however, must be established by evidence . . ." (294 U.S. at 68).

And, in the absence of evidence, presented under circumstances which accord the utility due process, the Court ruled that:

> "Good faith is to be presumed on the part of the managed of a business. • • • In the absence of a showing of inefficiency or improvidence, a court will not substitute its judgment for theirs as to the measure of a prudent outlay." (294 U.S. at 72).

The TAPS owners are clearly entitled to this presumption in these suspension proceedings.

VI. The Initial Rate Proposed by Exxon is Just and Reasonable Under an Appropriate Capitalization Standard

Even if this Commission could properly consider the capitalization approach advocated by Alaska and the Department of Justice, their implementation of their proposed methodology is patently wrong.

In order to depress the allowable rates for transportation via TAPS, Alaska's consultant Dr. Michael J. Ileo has repudiated his own representations, made under oath to the Alaska Pipeline Commission as a consultant to its Staff, earlier this year. In hearings before that Commission, in *Nikiski Alaska Pipeline Company,* Docket Nos. P-76-3 and P-77-3, Dr. Ileo stated that, in the case of a pipeline which is a wholly-owned subsidiary, the appropriate capital structure to be considered is not that of the pipeline, but that of the parent, stating:

> ". . . a critical issue which must be decided by the Commission is how to treat the ownership and consequently, the equity position, of Nikiski. There are three possible options open to the Commission:
>
> (1) treat Nikiski as if it stands alone as an independent company;
>
> (2) treat Nikiski as an operating subsidiary of Tesoro Petroleum Corporation, its parent; or
>
> (3) treat Nikiski as being owned by certain institutional investors.
>
> ". . . [I]t would be incorrect in my judgment to treat Nikiski as if it were an independent company as long as it is wholly owned by Tesoro. This is the case because all of the capital of Nikiski is raised by Tesoro. Moreover, despite the fact that Nikiski appears to be nearly 100% debt financed by Tesoro, it is truly financed by the consolidated capital structure of Tesoro just as any wholly owned operating subsidiary of Tesoro. The fact that Nikiski would never have been constructed without the financial backing of Tesoro, as reflected in the testimony of Nikiski, clearly reflects this situation" (Direct Testimony of Michael I. Ileo, March 14, 1977, pp. 61-62).

Moreover, in that same proceeding, Mr. David Parcell, who like Dr. Ileo is employed by Technical Associates, Incorporated, stated that, because of its status as a wholly-owned subsidiary of Tesoro, the separate capital structure of Nikiski was "arbitrary and meaningless," explaining that:

> ". . . Nikiski is apparently financed as part of the overall Tesoro system with all of its capital essentially coming through the parent (whether directly or indirectly). It is thus fair to say that Tesoro could classify all of its investment in Nikiski as either capital stock, advances or a combination of the two, regardless of the capital structure utilized to obtain the funds to capitalize Nikiski. Consequently, to set rates on this basis would be improper since it could easily lead to excessive earnings at the parent level" (Direct Testimony of David C. Parcell, March 14, 1977, p. 4).

Mr. Parcell also noted that since "virtually all of the petroleum pipeline companies are owned, either singularly or as joint ventures, by oil companies," the same conclusions are equally applicable to other subsidiary pipelines (*id.* at p. 2.).

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Somehow between March 14, 1977 and June 15, 1977, Dr. Ileo seems to have forgotten his testimony before the Alaska Pipeline Commission. Here, despite the fact that Exxon, like Nikiski, is a wholly-owned subsidiary and that TAPS would never have been built without the financial backing of parent companies, Dr. Ileo completely ignores the capital structure of the parents and utilizes only the capital structure of the respective joint interest shares of TAPS. Dr. Ileo's methodology in this proceeding is, accordingly, clearly contrary to his own judgment.

Dr. Ileo's conclusions concerning the impropriety of utilizing the capital structure of a subsidiary pipeline in determining return as set forth in his testimony before the Alaskan Pipeline Commission are confirmed by the verified testimony of Raymond G. Gary, submitted by the Association of Oil Pipelines in Ex Parte 308 on behalf of Exxon and other members referred to above. Mr. Gary stated at pages 10 through 12 of his testimony that (See Appendix C to this Reply):

> "Most oil pipelines are highly leveraged with debt, in the case of new systems, representing initially as much as 90% of total capitalization. Such debt ratios decrease, however, over the life of the particular pipeline. The high degree of leverage exhibited by pipeline companies is a direct outgrowth of the Elkins Act Pipeline Consent Decree entered into in 1941, which limited dividends on pipelines (owned by companies subject to the Consent Decree) to 7% of the ICC valuation of common carrier property owned and used in the business. The 7% figure established in 1941 is, however, unrealistic in terms of financial conditions prevailing today and had led to the financial patterns which have since evolved.

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> In order to maximize returns on total capital within the absolute limit on permissible payouts, pipeline companies were forced to adopt the policy of financing new investments by debt to the greatest extent possible. In essence, the initial debt ratios of pipeline companies are artificially high, and on a stand-alone basis (i.e., without shipper-owner guarantee of debt) would be much lower.
>
> "Shipper-owner support of pipelines has enabled pipeline companies to place large amounts of debt, both as to dollar amount and ratio of debt to equity, with private and public investors at interest costs which reflect the financial strength of the shipper-owners. In contrast, a representative sample of industrial companies indicates a debt ratio (long-term debt as a percent of capitalization) of about 20% for Aaa/AAA (highest grade) companies and a debt ratio of about 43% for Baa/BBB (medium grade) rated companies. • • •
>
> "In the case of oil pipelines, however, debt ratios are higher because of the use of the borrowing capacity of shipper-owners. It must be recognized that lenders are willing to commit funds to the debt securities of oil pipeline companies having such a high degree of leverage *only* because of shipper-owner support, be it direct or indirect (through completion, throughput and cash deficiency agreements). But, as noted above, such shipper-owner support, even if indirect, is in essence an additional equity investment of the parent company. Were support from financially strong shipper-owners not available, lenders would not permit such a high degree of leverage in oil pipelines even if the relative risk charac-

teristics of the pipeline in question were at the low end of the risk spectrum. Indeed, prior to the existence of the Consent Decree, the average of oil pipeline debt ratios was below 20%. • • •

"Because the Consent Decree has resulted in a high degree of leverage in the pipeline industry, each shipper-owner is using up a portion of its available borrowing capacity in support of the pipelines. Not only is the shipper-owner using up its borrowing capacity, which could otherwise have been used elsewhere, but it is also assuming *both* the credit and the business risks of the pipeline. This is a commitment of capital to the total cost of the pipeline, equivalent in substance to a direct equity investment. Consequently, in order to maintain its debt ratio at a level which preserves its financial integrity, the shipper-owner may be forced either to forego other investments or to sell additional equity." (Emphasis in original text.)

As Mr. Gary states, the fact that the parent assumes *both* the business risks and the credit risks of a pipeline subsidiary makes its investment in the subsidiary the equivalent of 100% equity investment. Dr. Ileo's recommendation in the *Nikiski* case that the capital structure of the parent be "flowed through" to the subsidiary is thus less favorable to the pipeline than would be treating the parent's investment entirely as equity, as Mr. Gary has shown would be justified.

If Dr. Ileo had utilized the methodology which he employed in the *Nikiski* case in this case, he would have found that Exxon's $6.27 rate results in a return on equity of only 12.56%. By contrast, the $3.90 rate derived under the

methodology adopted by Dr. Ileo solely for the purposes of this case produces a return on equity of only 5.1% under the methodology he espoused in the *Nikiski* case. Again, using the 14% return on equity sponsored by the Department of Justice and Dr. Ileo's *Nikiski* methodology, would produce a rate of $6.73, compared with the $4.19 rate the Department advocates. In turn, the $4.19 rate proposed by the Department of Justice results in a return on equity of only 6.0% (See Table 4).

TABLE 4

ALTERNATIVE EXXON RATES USING EXXON CORPORATION'S CAPITAL STRUCTURE AND METHODOLOGY SPONSORED BY DR. ILEO IN NIKISKI PROCEEDING

I. ALLOCATION OF EXXON TAPS INVESTMENT BASED ON EXXON CORPORATION'S CAPITAL STRUCTURE (1976)

	%	$ (000 omitted)
Debt	21.35	$ 393,523
Deferred Taxes	7.90	145,613
Equity	70.75	1,304,064
	100.00	$1,843,200

II. ALTERNATIVE TRANSPORTATION RATES BASED ON VARYING EQUITY RETURN RATES

A. Expenses (Millions of $)

Operating	$ 14.3
Maintenance	19.3
General	46.4
Depreciation	73.7
Removal and Restoration	16.4
Interest ($393.6 at 8%)	31.5
	$201.6

B. Rates Based on Various Returns on Equity

	Return on Equity				
	11%	12.56%	13%	14%	15%
Expenses (II.A. above)	$201.6	$201.6	$201.6	$201.6	$201.6
Federal Tax (48%)	132.7	151.2	156.8	168.8	180.9
State Tax (9.4%)	28.7	32.7	33.9	36.5	39.1
Return on Equity	143.7	163.8	169.8	182.8	195.9
Total Revenue Required	$506.7	$549.3	$562.1	$589.7	$617.5
Throughput ($\overline{M}$ Barrels/yr.)	87.6	87.6	87.6	87.6	87.6
Tariff Rate ($/bbl.)	$5.78	$6.27	$6.42	$6.73	$7.05

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Apart from their unwarranted use of inappropriate capital structure to determine rates, Alaska and the Department of Justice are guilty of other errors. For example, the Department of Justice assumes that the appropriate rate of return on equity is independent of the debt/equity ratio. As shown in the Federal Power Commission's Recommendation to the President on the Alaska Natural Gas Transportation Systems, May 1, 1977, this assumption is contrary to all conventional financial wisdom. In that Recommendation, the FPC clearly illustrated that as the proportion of equity in relation to debt decreases, the return on equity properly increases. Thus, the FPC approved an 18% after-tax return on equity as just and reasonable, based on a 50/50 debt/equity ratio, reflecting an overall rate of return to cover debt and equity of 23%. At the same time, the FPC recognized that if the debt/equity ratio were 25/75, the equity return would properly be lower (13.7%), and, with a debt/equity ratio of 75/25, the return would be higher (31%). The FPC stated:

> "Such after-tax returns on equity are in line with the returns petroleum companies currently earn on their integrated operations, . . . *if comparable D/E ratios are assumed*". (Emphasis in original text.)

The Department of Justice, on the other hand, picked 14% as a rate of return on the basis of returns allowed to a gas pipeline, the Bell System, and Williams Pipeline without even investigating the debt/equity ratios of those companies, and then applied it uniformly to three different debt/equity ratios.

Furthermore, both Alaska and the Department of Justice make the same error as did the Bureau in assuming that the amounts collected to meet restoration and dismantling

costs are non-taxable, thus substantially understating expenses in their rate calculations.

Other than the adjustments set forth above to reflect the parent company's capital structure, Exxon has not attemped to restate the rate calculations made by Alaska and the Department of Justice to eliminate other errors; nor has Exxon attempted to determine an appropriate rate of return on equity, utilizing the pipeline's capital structure, which reflects the comparative risk of the TAPS project. The FPC's Recommendation clearly shows that with the debt/equity ratio proposed for TAPS standing alone, the rates of return on equity proposed by Alaska and the Department of Justice are absurd.

Given the fact that the capitalization calculations utilized by Alaska and the Department of Justice are clearly improper in light of Sections 15(7) and 19a of the Interstate Commerce Act, the only purpose in dealing with these calculations at all is to demonstrate that, if that methodology is properly applied, even using the data employed by Alaska and the Department of Justice for every element except capital structure, the 12.56% return on equity resulting from Exxon's $6.27 rate is clearly not unreasonably high.

VII. The Initial Rates Proposed by the Arctic Slope Regional Corporation are Clearly Inadequate

ASRC proposed as an initial rate for Exxon $3.27 per barrel. Such rate reflects a reduction of $3.00 below the rate in Exxon's tariff. Indeed, it appears that ASRC has simply deducted $3.00 from the rates of each of the TAPS carriers.

Perhaps not by coincidence, Exxon's per barrel costs, including operating expenses, depreciation, reserve for removal and restoration, interest, and income taxes, are

$3.27 per barrel. The rate proposed by ASRC thus provides no return on equity whatever and is clearly inadequate.

ASRC's other concerns are equally inappropriate. Its arguments concerning entry barriers precluding other producers from explorating new areas, which it alleges might result from an unlawfully high tariff assume that this Commission is not prepared to undertake the final determination of the lawfulness of the proposed rate in any reasonable time. Its contentions concerning delays in receiving its share of the royalty payments to Alaska are based on the same premise.

VIII. Although the Commission Has No Power to Impose a Refund Condition Exxon is Willing to Amend its Tariff to Adopt an Appropriate Refund Provision if its Rate is not Suspended

Protestants contend that the rates as filed should be suspended with leave given the TAPS carriers to refile on a lower basis of rates, with the lower rate made subject to a tariff rule providing for refund to shippers of any portion of those lower rates which the Commission, after investigation, finds to be unjust and unreasonable.

As Exxon has shown above, the Commission has no authority to coerce the acceptance of a lower initial rate through its suspension powers. Furthermore, although section 15(7) of the Act provides that if the Commission investigates, but does not suspend an *increased* rate filing, it may order the carrier to keep accurate accounts and to refund, with interest, to shippers any portion of the increase which, after its investigation, is found to have been been unjustified, this provision for refund does not apply to an initial rate, as the Bureau of Investigations and

Enforcement (p. 33) seems to recognize. Moreover, there is no implied authority for the imposition of such a condition in the exercise of the suspension power.[12]

If, however, the Commission determines to exercise its discretion to permit Exxon's tariff rate to take effect as filed, as we believe it must, Exxon is willing voluntarily to file a supplement to that tariff incorporating a refund rule as described below.

Such a refund rule will fully protect the crude oil shippers, the State of Alaska, and ASRC.[13] Exxon has no doubt that if a shipper receives a refund based on a determination that a transportation charge is unlawfully high, thus affecting the wellhead price of the crude oil transported, the owner of a market-value royalty would be entitled to recover its proportionate share of that refund.

12. The Bureau cites *Admiral-Merchants Motor Freight, Inc.* v. *United States,* 321 F.Supp. 353 (D. Colo.), *aff'd* 404 U.S. 802 (1971), as support for its contention that the Commission has authority to attach a refund condition to the TAPS initial rates. But that decision does not support the Bureau's argument. In the I.C.C. proceeding which culminated with *Admiral-Merchants,* the Commission had imposed the refund obligation as a condition to granting the carriers' motion for an extension of time. The court found the refund condition lawful as, in effect, a *quid pro quo* for the extension requested by the carriers. In the instant proceeding, in contrast, no similar benefit would be conferred upon the carriers as a tradeoff for a refund condition. Coercing carriers to file a rate below what they deem to be a reasonable level as the price of not having any rate at all, can hardly be deemed beneficial. For this reason, *Admiral-Merchants* does not support the imposition of a refund obligation on the initial rates filed by the TAPS carriers.

13. The Arctic Slope Regional Corporation suggests (pp. 21-22) that the refund rule would be inadequate protection in that even if the Commission should ultimately find some portion of the rates unreasonable the pipeline owner-shippers might refuse to apply for refunds. This argument is unfounded: the refund rule is self-executing, Ex Parte No. 281, *Increased Freight Rates and Charges* —1972, Order served May 14, 1973 (". . . respondents are obligated to comply with the refund rule, and no order should be necessary").

As to the rate of interest to be incorporated in such a refund rule, Exxon submits that the rate should not exceed 8 percent, rather than be fixed at 9 percent, as advocated by the Bureau of Investigation and Enforcement.[14] Eight percent is the rate which Exxon, by tariff rule, will charge shippers for delinquencies in the payment of transportation charges.

If the Commission authorizes it to do so, Exxon is willing to supplement its tariff (I.C.C. No. 125) issued June 8, 1977, on one day's notice, by adding thereto a refund rule essentially as follows:

"Special Rule No. 1—Provision for Refund:"

> "In the event that the Interstate Commerce Commission determines that any portion of the rate established hereby in the first instance for the movements from Prudhoe Bay to Valdez, Alaska exceeds a maximum reasonable level or is otherwise unlawful, and that determination is sustained on judicial review, carrier shall refund that portion of the rate in excess of the rate found to be just and reasonable, together with eight percent interest per annum from the date of payment."

14. The Commission has recently directed that an award of damages covering the period 1970-1974, for violation of Section 3(4) of the Act be paid with simple interest at *four* percent. *Investigation Into Lawfulness of Interchange Arrangements Between The Bangor and Aroostook Railroad and CP Rail at Brownsville Junction, Maine* (Docket No. 35940 *et al.,* Report and Order of the Commission, served February 11, 1977, p. 57). And in Ex Parte No. 318, the railroads incorporated in their master tariff, and the Commission found appropriate, a refund provision (Rule 13) with interest at the rate of *five* percent.

Protest Reply of Exxon Pipeline.

CONCLUSION

It is Exxon's position that the initial rate of $6.27 per barrel published in its tariff for transportation of crude oil from Prudhoe Bay to Valdez, Alaska, for shipment to points outside of Alaska cannot properly be suspended by this Commission. Whether tested by the conventional standards utilized by this Commission, or by the standards proposed by protestants, the $6.27 rate has not been shown by protestants to be unjust or unreasonable. Contentions with respect to this rate which require resolution on the basis of an evidentiary hearing can be dealt with in subsequent proceedings related to valuation or investigation of the rate. On the basis of the present submission to the Commission, the protests should be rejected and the petitions for suspension denied.

Respectfully submitted,

EXXON PIPE LINE COMPANY

By RICHARD J. FLYNN
LEE A. MONROE
JOSEPH B. TOMPKINS, JR.
Sidley & Austin
1730 Pennsylvania Ave., N.W.
Washington, D.C. 20006
Its Attorneys

FRANK L. HEARD, JR.
P.O. Box 2220
Houston, Texas 77001
Of Counsel

Dated: June 22, 1977

[Appendices Omitted (reproduced in part in Vol. III)]
[Certificate of Service Omitted]

Reply of BP Pipelines Inc. to Petitions of the State of Alaska, Arctic Slope Regional Corporation, Department of Justice and Bureau of Investigations and Enforcement for Suspension and Investigation of its Initial Tariffs, June 22, 1977.

BEFORE THE

INTERSTATE COMMERCE COMMISSION

[Caption Omitted]

BP Pipelines Inc. ("BP") acting through its undersigned counsel, hereby replies to the petitions of the State of Alaska ("Alaska"), Artic Slope Regional Corporation ("ASRC"), Antitrust Division, U.S. Department of Justice ("Justice"), and the Bureau of Investigations and Enforcement ("Bureau"), all dated June 15, 1977, to suspend and investigate BP's Tariffs 1 and 2. This reply is filed pursuant to Rules 42(a) and 200 of the Commission's General Rules of Practice and in accordance with Supplemental Notice concerning Filing of Protests and Replies to Initial Tariffs for the Trans Alaska Pipeline System ("TAPS") issued by the Commission on June 13, 1977.

INTRODUCTION

BP issued its Local Pipeline Tariffs 1 and 2 on June 3, 1977, effective June 20, 1977. Supplement 1 to I.C.C. 2 was issued by BP on June 15, 1977 with special permission of the Commission (77-4069) to postpone the effective date to June 30, 1977.

SUMMARY OF BP'S POSITION

This Commission should refuse to grant the requests for suspension and investigation for the following reasons:

1. The Commission lacks the statutory power to suspend BP's initial rates without a full hearing.

2. Suspension of BP's initial rates would prevent it from beginning operation in contravention of the Congress-

ional intent as expressed in the Trans Alaska Pipeline Authorization Act.

3. The Commission has no legal authority to suspend BP's tariff and require BP to file a lower tariff as suggested by protestants. To do so would be an unconstitutional taking of BP's property without due process of law.

4. The protestants have wholly failed to prove a prima facie case that BP's rates are unlawful.

1.

THE COMMISSION LACKS THE STATUTORY POWER TO SUSPEND BP'S INITIAL RATES WITHOUT A FULL HEARING.

The Commission has no statutory power to suspend an initial tariff of a new carrier like BP on the complaint of non-shippers, when BP has no other pipeline operations and consequently no revenues after suspension.

The Commission suspension powers are derived from 49 U.S.C. § 15(7), which reads in pertinent part as follows:

> "Whenever there shall be filed . . . a *new* . . . rate . . . the Commission shall have . . . authority . . . to suspend . . . but not for a longer period than seven months . . ." (Emphasis added.)

The Commission has the power, under 49 U.S.C. § 15(1) to cancel rates after they go into effect, but only after a full hearing.

49 U.S.C. § 15(1) reads in pertinent part as follows:

> ". . . *after a full hearing* . . . the Commission is authorized to determine and prescribe what will be the just and reasonable . . . rate." (Emphasis added.)

The present proceeding does not constitute a "full hearing" as required by Section 15 (1) of the Interstate Commerce Act or by the Administrative Procedure Act (5 U.S.C. §§ 555, 556, 557).

Section 556(d) of the APA reads in part as follows:

> "Every party shall have the right to present his case or defense by oral and documentary evidence, submit rebuttal evidence, and to conduct such cross-examination as may be required for all a full and true disclosure of the facts."

This right to a full hearing is strictly enforced. *Morgan* v. *U.S.*, 304 U.S. 1 (1938).

None of the cases cited by protestants as giving the Commission authority to suspend initial tariffs involve the suspension of the rates of a new carrier that has no other revenues, but involved individual rates that had a relatively minor impact on the overall revenues of the carriers. The question of whether the Commission had the power to suspend initial rates for a company starting in operation was not involved in any of the cited cases. None of the cases cited by the Bureau in footnote 11, page 12 of its protest involved the suspension power of the Commission under Part I of the Act. The only case found involving facts similar to those in this proceeding was in *The Matter of Wharfage Charges of the Galveston Wharf Company*, I & S. Docket No. 44 (1912) 23 I.C.C. 535, 537. In that case, Commissioner Harlow had this to say:

> "It was the first and only tariff of Galveston Wharf Company on file here, and an order suspending its operation *would have left the wharf company without any lawful rates and would therefore have obligated it either to cease its operations or to handle*

> ***the traffic of the port in violation of the act.*** ***We*** therefore allowed the tariff to go into effect . . ." (Emphasis added.)

Assuming *arguendo* that this Commission has the statutory authority to suspend initial tariffs, it would be a gross abuse of discretion for this Commission to suspend BP's initial tariffs and leave them with no revenues whatsoever on a $1.3 billion investment.

2.

SUSPENSION OF BP'S INITIAL RATES WOULD PREVENT IT FROM BEGINNING OPERATION IN CONTRAVENTION OF THE CONGRESSIONAL INTENT AS EXPRESSED IN THE TRANS ALASKA PIPELINE AUTHORIZATION ACT.

The legislative history of the Trans Alaska Authorization Act, 43 U.S.C. § 1651-55 reflects that Congress considered that the completion and operation of TAPS was urgently necessary in the public interest. Certainly, Congress did not anticipate that this Commission would suspend the operation of this vital facility when all of the parties' interest can be adequately protected by following Commission procedures. (Senate Report No. 93-207, 93rd Cong., 1st Sess., U.S. Code Congressional and Administrative News, 1973, page 2417, et seq.)

3.

THE COMMISSION HAS NO LEGAL AUTHORITY TO SUSPEND BP'S TARIFF AND REQUIRE BP TO FILE A LOWER TARIFF AS SUGGESTED BY PROTESTANTS. TO DO SO WOULD BE AN UNCONSTITUTIONAL TAKING OF BP'S PROPERTY WITHOUT DUE PROCESS OF LAW.

Alaska suggests that this Commission coerce BP into accepting a suspension and refiling at $4.42 per barrel.

ASRC would accept $3.04 per barrel. Justice suggests a range of $4.23 to $4.83 per barrel depending on a hypothetical debt/equity range. The Bureau came up with a BP tariff of $4.59 per barrel. No two protestants used the same formula or the same assumptions. Nor did any two protestants come up with the same relationship between BP and the other TAPS carriers.

Should this Commission attempt to coerce BP into filing a lower tariff in the recommended or any other prescribed range, this would constitute illegal ratemaking, would violate the Administrative Procedure Act requiring a full hearing prior to establishing a tariff, and would be confiscatory and an unconstitutional denial of due process under the Fifth Amendment to the United States Constitution. *Moss* v. *Civil Aeronautics Board,* 430 F.2d 891 (D.C. Cir., 1970).

THE PROTESTANTS HAVE WHOLLY FAILED TO PROVE A PRIMA FACIE CASE THAT BP'S RATES ARE UNLAWFUL.

There is no presumption of wrong arising from BP's tariff filing. Indeed, the presumption of honest intent and right conduct attends its action. Accordingly, this Commission requires that a prima facie case of unlawfulness be presented by the protesting parties before its power to suspend is exercised. The suspension procedure is comparable to a restraint proceeding in a court of equity. It is an extra ordinary remedy which the Commission historically exercises with restraint. (*Ratemaking Powers of the Interstate Commission,* by former Chairman Howard Freas, 31 George Washington Law Review, Oct. 1962, page 54, at page 67.)

The only real issue of unlawfulness in this proceeding is whether the rates are "unjust and unreasonable" under Section 1(5) of the Interstate Commerce Act (49 U.S.C.

§ 1(5)). To meet their burden of proof to justify a suspension, protestants must allege and prove that the tariffs are clearly excessive.

We see no necessity to catalogue all the unsupported generalizations in the various protests, and we will not spend time responding to speculation as to what might be proven in the future. An evidentiary hearing is the proper and only place to join issue on the facts and test the evidentiary support for the allegations of a complaint. We will, however, note some of the more glaring defects and omissions in the presentations of the protestants.

The principal underlying thesis of the protests appears to be that the Commission should, in this summary proceeding involving eight out of more than 100 oil pipeline companies, make a radical regulatory departure from 70 years of pipeline regulation. This Commission has always recognized the different regulatory standards which properly apply to oil pipelines under the Interstate Commerce Act as opposed to those applied to certificated public utilities. Oil pipelines have been recognized as "a unique type of transportation system." *United States Department of Defense* v. *Interstate Storage and Pipeline Corp.*, 353 I.C.C. 397, 404 (1977). If what has heretofore been a highly successful mode of regulation of pipelines as competitive common carriers is to be abandoned, it should not first be done in a summary protest proceeding involving the initial tariffs of eight pipeline companies and a large project having no operating history. Questions on the methodology and application of valuation and on proper standards for measuring tariff reasonableness are of great significance, and their determination can have far reaching impact on a multi-billion dollar American industry. Decisions on these questions must be deferred to a proceeding affording time

and opportunity to all interested parties for full presentations and reasoned deliberations. The Commission's Ex Parte No. 308 is just such a proceeding.

In making their arguments for a utility type rate of return on equity, the protestants gave no recognition to the realities of oil pipeline financing and capital structure. The high debt/equity ratios indicated on the books of the pipeline companies which owns TAPS do not reflect the real investment in those companies by their parent owners. BP's parent shareholder has put more at risk in the venture than a capital contribution of 15 percent. It has also unconditionally guaranteed all of BP's debt borrowings. As an independent company without these financing guarantees, BP could not have attracted the required capital for its participation in TAPS.

Analysis in terms of traditional shareholder equity investment where liability is limited to the investment cannot meaningfully apply where the shareholder has unlimited liability for all the corporation's debt as well as for contributed capital. As stated by Mr. Raymond B. Gary at page 8 of his testimony in Ex Parte No. 308.

> "In this sense the high debt ratios of oil pipeline companies are misleading since the shipper-owners are responsible for the total capitalization, both debt and equity. In essence, the debt supported by the shipper-owners could be viewed as equivalent to an equity investment because the shipper-owners are bearing the risks of business failure of the pipeline operations. The end result is that the shipper-owners have dedicated one of their valuable assets, namely their borrowing capacities, to assist in financing pipeline systems."

Although the State of Alaska's protest fails to speak of the special relationship between the pipelines and their

parents, the State's witness, Dr. Michael J. Ileo, is certainly sensitive to the difference between a financially independent company and a pipeline subsidiary. In his written testimony before the Alaska Pipeline Commission in *Nikiski Alaska Pipeline Co.*, Dockets P-76-3 and P-77-3 (March 14, 1977) he said:

> "However, it would be incorrect in my judgment to treat Nikiski as if it were an independent company as long as it is wholly owned by Tesoro. This is the case because all of the capital of Nikiski is raised by Tesoro. Moreover, despite the fact that Nikiski appears to be nearly 100% debt financed by Tesoro, it is truly financed by the consolidated capital structure of Tesoro just as any wholly owned operating subsidiary of Tesoro. The fact that Nikiski would never have been constructed without the financial backing of Tesoro, as reflected in the testimony of Tesoro, clearly reflects this situation."

In the *Nikiski case*, Mr. Ileo applied the debt/equity structure of the parent company (37.3 percent debt) rather than of the pipeline company (100 percent debt) and recommended a 13 percent return on the parent's equity structure in determining a fair rate of return.

Combined debt/equity ratios for 29 integrated petroleum companies are presented in Exhibit F of the Bureau's protest, and they show a 1975 ratio of 24 percent debt.

In any event, Alaska cannot make a prima facie case of illegality by presenting a theory of regulation which has never been recognized by this Commission. Alaska bases its entire case on a statement by Dr. Michael J. Ileo. Dr. Ileo calculated, what he considered as fair rates of return for the BP solely on the basis of common equity returns on an original cost rate base (Schedules 6A, 6B), methods

which have never been employed by this Commission and were rejected in all of the *Williams Brothers* cases. In Nikiski, Dr. Ileo had this to say:

> "The I.C.C. with regard to pipelines, the Hope[1] principles are not applicable and hence you can't compare rates of return for one entity whose . . . for which the Hope principles are applicable, to another entity where the Hope principles are not applicable." (Tr. 267, March 30, 1977)

The Commission, in its Order of December 3, 1976, in *Williams Brothers* Docket 35533, stated:

> "Use of either original cost or actual net investment as the rate base would be such a fundamental change from previous policy that it may not properly be adopted for the first time in a proceeding involving the existing rates of a particular pipeline."

If the Commission considered that such fundamental changes in policy should not be made in *Williams* after a full hearing, then such changed theories and method certainly should not be applied in a suspension proceeding.

The protestants would also eliminate or radically alter the Commission's valuation procedures. As stated above, this is not the proceeding to undertake such a task, and Section 19a of the Act cannot be amended here. For purposes of its recent submission to the Commission on its tariff, BP calculated its estimated valuation in accordance with the instructions of Mr. William T. Bono, Chief, Section of Cost and Valuation, in his letter of April 22, 1977 and as detailed by Mr. Jesse C. Oak, Senior Valuation Engineer in his testimony in Ex Parte No. 308.

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1. The *Hope case* (*F.P.C.* v. *Hope Natural Gas*, 320 U.S. 591 (1944) is the classical monopolistic utility-original cost-return on equity case.

Protest Reply of BP Pipelines.

The return on valuation which is a measure of a proper tariff levels is currently being reviewed in Ex Parte No. 308. The testimony in that proceeding by Mr. Raymond B. Gary supports returns of 13 to 14 percent for minimum risk pipelines. The Bureau proposes a 10 percent return on valuation as a proper interim measure of tariff reasonableness, but it did not indicate how that rate was developed. While the Bureau suggests an increase from 8 to 10 percent as the guideline on valuation returns, it proposes an increase from 4 to 9 percent when discussing interest on refunds since the 4 percent rate adopted in 1946 "has outlived its relevance." An example of the inadequacy of a 10 percent return is BP's average interest cost of almost 9.6 percent.

The testimony in Ex Parte 308 by Mr. Raymond B. Gary supports returns of 13 to 14 percent for minimum risk pipelines. With an optimistic assumption of a full level throughput of 15.84 percent of 1.2 million barrels per day throughout 1978, BP's tariff will not result in a return on valuation in excess of this rate.

We note that the Bureau has emphasized that rates should be cost based with cost differences warranting different rates. The Bureau proposed rates, however, would run counter to this rule and give the carriers with the higher costs the lower rates.

The protestants have failed to give recognition to the fact that all of the pipeline companies are not owned by parents who also own North Slope production in similar proportions to the pipeline ownership. The parents of Union and BP are not North Slope producers. Without the comforting assurance that owner-produced oil will be available for shipment through our pipeline space, we are subject to greater risks of throughput and revenue variations when production is reduced.

Protest Reply of BP Pipelines.

None of the protestants has proposed a meaningful test year or given any recognition to the projected realities of the first year's pipeline operation. If we apply the highest of the tariff rates urged by protestants to an assumed throughput for 1977 which makes no allowance for operational delays or shortfalls, the resulting revenues fail to afford BP Pipelines sufficient return for coverage of its interest costs. This is demonstrated on Attachment A to this response.

As stated by Dr. Michael J. Ileo in his testimony in FPC Docket No. 20376 at page 17: "Under most regulatory statutes, utility rates cannot be so low that they are confiscatory; they must be at least sufficient to cover debt cost."

We submit that the protestants in this proceeding have failed to give the Commission any proper basis for the establishment of a lower tariff rate. Any forced reduction in the rate in this proceeding would be procedurally and constitutionally confiscatory, and the rates proposed by protestants would also be confiscatory in a very real economic sense.

Conclusion

This Commission has successfully regulated oil pipelines since 1906, recognizing that because of their shipper owner relationships, pipelines are unlike no other regulated business.

The Commission, through its sensible regulations, has promoted a pipeline network that is unique to this country and has contributed greatly to this country's high standard of living. Unlike other forms of transportation, oil pipelines have been built by private capital without government subsidies. The pending legislation in Congress to create a Department of Energy would transfer I.C.C. regulations over oil pipelines and FPC regulations over gas pipelines.

According to the Oil & Gas Journal, June 13, 1977, page 19, the FPC will transfer 1,458 employees to the new department as compared with 17 employees from the I.C.C. The difference in these numbers may help to explain the greater health and vitality of the oil pipeline industry as opposed to the gas industry. Being uncertificated, and having limited customers, oil pipelines are completely unlike monopolistic public utilities.

No shippers have protested BP's tariffs. Alaska and ASRC filed their protests to reduce the rates so as to increase the price of North Slope crude and the state's royalty and tax revenues. Justice and Bureau are using this forum to urge changes in the Commission's regulatory practices to utility type regulations.

None of the protestants claim that the BP rates, or that of the other carriers, are out of line with the earnings of other oil pipelines in this country—earnings which are well known to this Commission and have been reported to Congress. The reason this comparison was not made is obvious, the TAPS owners have posted tariffs which will result in lesser rates of earnings than those of many other pipelines. All of protestants assume, without factual support, that the valuations and depreciation rates are excessive. They ignore the fact that valuation and depreciation proceedings are now underway in accordance with this Commission's procedures. Alaska has spent substantial sums in developing testimony for those two proceedings.

BP has serious doubts as to whether the Commission has any statutory power to suspend BP's initial rates and leave it with the dilemma of going out of business or accepting a permanent loss of revenues without the opportunity to a full rate hearing. Assuming, *arguendo*, that the Commission has the power, it would be a gross abuse of the Commission's discretionary authority to suspend rates on new

theories or utility principles that have not been heretofore applied by the Commission.

A suspension placing BP under economic duress to file a lesser rate as suggested by protestants, would, under the circumstances, be illegal ratemaking without a full hearing as required by the Interstate Commerce Act and the Administrative Procedure Act, and would constitute an illegal taking of BP's property in violation of the due process clause of the United States Constitution.

Although Alaska is not a shipper and thus not entitled to reparations directly, in the event this Commission ultimately finds that the rates are excessive and orders reparations, these reparations will be available for flow through to Alaska.

BP respectfully submits that protestants have wholly failed to make a prima facie case of unlawfulness and that suspension of BP's tariffs should be denied. Protestants will have their day in court in the pending valuation, depreciation and rate hearings and can suggest changes in methodology in Ex Parte No. 308. In the meantime, all of the protestants' rights are adequately protected by the reparation provisions in the Interstate Commerce Act.

Protest Reply of BP Pipelines.

Of Counsel:

GLEN E. TAYLOR
100 Pine Street
San Francisco, CA 94111

GEORGE H. HAGLE
100 Pine Street
San Francisco, CA 94111

JACK VICKREY
2530 Pennzoil Tower
700 Milam
Houston, Texas 77002

Attorneys for
BP Pipelines Inc.

[Certificate of Service Omitted in Printing]

Protest Reply of BP Pipelines.

ATTACHMENT A

BP PIPELINES INC.

1977 Operating Results Based on $4.59 Tariff and Maximum Throughput For Operations Commencing August 1, 1977

Throughput (million barrels)	20
Operating Revenue at $4.59 tariff	91.8
Operating Expense:	
Depreciation	24.9
Dismantling/Restoration	2.8
Other Operating Expenses	27.6
Net Carrier Operating Income	36.5
Interest Expense	47.9
Income Tax	—
Net Income	(11.4)

NOTE: Based on the tariff proposed by Dr. Ileo, $4.42, BP's interest expense would still not be covered after eight months of operation at full throughput.

Response of ARCO Pipe Line Company to Protests and Petitions for Suspension and Investigation of ICC Tariff No. 1030, June 22, 1977.

BEFORE THE

INTERSTATE COMMERCE COMMISSION

[Caption Omitted]

RESPONSE OF ARCO PIPE LINE COMPANY TO PROTESTS AND PETITIONS FOR SUSPENSION AND INVESTIGATION OF ICC TARIFF NO. 1030 ISSUED MAY 31, 1977

Protest Reply of ARCO Pipe Line.

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RESPONSE OF ARCO PIPE LINE COMPANY TO PROTESTS AND PETITIONS FOR SUSPENSION AND INVESTIGATION OF ICC TARIFF NO. 1030 ISSUED MAY 31, 1977

On May 31, 1977, ARCO Pipe Line Company ("ARCO Pipe Line") issued its initial tariff for the transportation of petroleum through its portion of the Trans Alaska Pipeline System ("TAPS"). On June 15, 1977, protests and petitions for suspension and investigation of that initial tariff, and of the initial tariffs issued by six other owners of undivided interests in TAPS, were filed by the State of Alaska ("Alaska"), the Antitrust Division of the Department of Justice ("Antitrust Division"), the Bureau of Investigations and Enforcement of the Interstate Commerce Commission ("Bureau"), and the Arctic Slope Regional Corporation ("ASRC"). Pursuant to the Commission's "Supplemental Notice Concerning Filing of Protests and Replies to Initial Tariffs for the Trans Alaska Pipeline System," issued June 13, 1977, ARCO Pipe Line hereby responds to the various protests and petitions filed with respect to its initial tariff.

The four protests can be dealt with as a group. They seek, with variations in detail, similar action from the Commission. They rest, again with minor deviations in detail, upon faulty notions of proper Interstate Commerce Commission procedure, of applicable law, and of public policy. Furthermore, all of the protests appear to be based upon concepts for determining rates of return which are either wholly untutored in sound economic principles or deliberately calculated to stampede this Commission into improvident and unlawful action.

SUMMARY OF RESPONSE

All of the protestants seek to have this Commission hurriedly rewrite its long-standing procedures for determining the allowable rate of return for petroleum pipelines in the context of a suspension proceeding, a proceeding which is summary in nature and which was never intended by statute, Commission regulation or established Commission practice to be the forum for revising rules or weighing disputed factual or economic contentions. Were the Commission to do what the protestants ask, it could not fail to act in violation of law. In addition, without benefit of a fuller record such actions would necessarily be arbitrary and capricious. The Commission would be compelled to reject its own ruling, announced just last December,[1] establishing the proper respective roles of individual pipeline tariff proceedings and the ongoing Ex Parte No. 308 rulemaking proceeding in which rate-of-return methodology for petroleum pipelines is receiving orderly and intensive consideration. Furthermore, the action which each protestant urges upon the Commission would have the Commission embrace a concept of rate-making which is not only new, but based upon wholly unsound economic principles. Indeed it would require acceptance of principles at odds with the recent testimony of the only economic "expert" whose views are made a part of any of the protests.[2]

Finally, the fundamental flaw of all of the protests, apart from the unlawful procedure which each of them suggests, is that they ignore the ability of the Commission, acting in

1. Petroleum Products, Williams Brothers Pipeline Company, Docket No. 35533, decided December 3, 1976.

2. Testimony of Michael J. Ileo before the Alaska Pipeline Commission, APC Docket Nos. P-76-3 and P-77-3, March 14, 1977 at 62, discussed *infra* at 48-50.

strict compliance with law, to protect the interests of both carriers and protestants. The Interstate Commerce Act contains specific, fair and adequate mechanisms by which those who are injured by a tariff ultimately found to be too high can be compensated for any damage. But the Interstate Commerce Act contains no similar protection for the carrier whose tariff is set too low. The carrier has no right of recoupment of the undercharge forced upon it, and appears to be precluded from making up for its losses or its unfairly constrained profits in subsequent years of operations. Under these circumstances, the equities are clear, and define the proper course of action for the Commission:

(1) Allow the tariffs here at issue, tariffs presumptively lawful under the Interstate Commerce Act, to become effective June 30, 1977;

(2) Order an investigation of the tariff rates and charges,[3] which investigation will satisfy the legitimate concerns of all protestants for impartial examination of the rates and charges;

(3) Instruct the ICC staff and the Administrative Law Judge or Commissioner designated to preside over the investigation to conduct it with all dispatch consistent with proper, thoughtful and careful consideration of the complex factual, economic and policy issues involved and with due regard for the rights of all parties.

This is a course of action consistent with law. It is a course of action consistent with ICC practice. And it is

3. The Commission, by its Order of June 17, 1977, has already ordered an investigation of the Rules and Regulations contained in the tariffs here at issue.

the only course of action which is fair to all parties, carriers and protestants alike.

I. THE COMMISSION LACKS AUTHORITY TO GRANT THE RELIEF REQUESTED BY THE PROTESTANTS.

All four of the protestants ask the Commission to suspend the proposed rate, with leave to refile at a prescribed lower rate, which would be effective on short notice. This requested relief is premised on two assumptions: (1) that the Commission has the power to suspend an initial, as opposed to a changed, rate, and (2) that the Commission can, prior to investigation, effectively prescribe a rate by requiring the carrier to elect between not operating at all and "voluntarily" canceling its tariff and refiling at a lower rate named by the Commission. Both of these assumptions are erroneous.

Moreover, two additional forms of relief requested by the Bureau (imposition of a refund condition and a requirement that the carriers furnish certain information outside the scope of discovery permitted by the ICC General Rules of Practice) are also beyond the authority of the Commission in this proceeding.

A. The Commission Does Not Have Authority To Suspend An Initial Rate.

All of the protestants assume the Commission has the authority to suspend the initial rates contained in the tariffs here at issue. That assumption is at odds with the language of the applicable statute, its legislative history, and the Commission's overall rate-making framework.

The protestants hinge their suspension claims on Section 15(7) of the Interstate Commerce Act ("Act"), 49 U.S.C. § 15(7), which provides that:

> Whenever there shall be filed with the Commission any schedule stating a *new individual or joint rate,* . . . the Commission shall have . . . authority . . . to enter upon a hearing concerning the lawfulness of such rate, . . . and pending such hearing and the decision thereon, the Commission . . . may . . . *suspend the operation and defer the use of such rate,* . . . but not for a longer period than seven months beyond the time when it would otherwise go into effect. . . . [Emphasis added.]

The term "new" rate, protestants assert, includes an initial rate such as that here involved.

A reading of Section 15(7) in its entirety, however, belies that assertion. In that subsection the term "new" rate is used interchangeably with the term "changed" rate. The next sentence provides that if, during the seven-month suspension period, "the proceeding has not been concluded and an order made . . . , *the proposed change of rate* . . . shall go into effect at the end of such period." (Emphasis added.) The statute makes no similar provision for anything other than a "changed" rate. Under settled Commission law, it is clear that a "changed" rate is one that modifies an existing rate of the same nature.[4] The term "change" of rate thus excludes an "initial" rate. As a result, either the term "new" rate must be read as synonymous with a "changed" rate (*i.e.*, not an "initial" rate), or the Commission would be faced with an anomalous situation where the suspension power would be applicable to an "initial" rate but the seven-month limitation would not. The latter interpretation would create an irreconcilable contradiction within the Act, as well as a clearly incorrect result.

4. *See, e.g.*, Animal Food, Middlewest to California, Idaho, and Utah, 332 I.C.C. 87, 88 (1967); Minimum Rates or Changes in Trunkline or New England Territories, 34 M.C.C. 776, 777 (1942).

The conclusion that "new" rate does not include "initial" rate is buttressed by the recent decision in *Delta Air Lines* v. *CAB*, 543 F.2d 247 (D.C. Cir. 1976). The court was faced with a petition to review the Civil Aeronautics Board's rejection of revised tariffs filed by several airlines. Examining the suspension provision in Section 1002(g) of the Federal Aviation Act,[5] which is patterned after Section 15(7) of the Interstate Commerce Act,[6] the court noted:

> This section gives the Board . . . authority over *"new," as opposed to initial, tariffs (i.e., tariffs which state a rate, rule, or regulation different from that in an existing, effective tariff covering the same service)* . . . . [543 F.2d at 254 (emphasis added).]

Within the context of the statute, then, "new" refers to "changed" but not "initial" rates, and the suspension power is not applicable to "initial" rates.[7]

In addition to the language of Section 15(7), the legislative history of that provision is wholly consistent with the view that Congress was limiting the suspension power to changed rates. The genesis of the suspension provision

5. 49 U.S.C. § 1482.

6. Section 1002(g) contains a proviso that the suspension provision "shall not apply to any initial tariff filed by any air carrier." In enacting that proviso, Congress made clear its intention to track the Interstate Commerce Act. *See* Senate Comm. on Interstate Commerce, 74th Cong., 1st Sess., Report on S. 3027 (Comm. Print Aug. 9, 1935) (citing Section 15(7) as a model for the Section 1002(g) suspension provision, including the language regarding initial tariffs). The result was a paraphrase of Section 15(7) that included an express statement of the lack of power to suspend initial tariffs.

7. *See also* Salt From Louisiana Mines to Chicago, Ill., St. Louis, Mo. and Intermediate Main Line Points, 69 I.C.C. 312, 313 (1922) ("By [Section 15(7)] we are given authority to determine the 'lawfulness' of a 'new' rate, *whether it be increased or decreased.*") (Emphasis added).

was the Commission's frequently expressed view that, in order adequately to prevent railroad abuse of shippers, it required authority to restrain "advances," or increases, in rates. The most effective grant of authority, the Commission suggested, would be the power to maintain the "status quo while proceedings are pending to test the reasonableness of the *advance.*"[8]

Congress responded to the Commission's recommendations by passage of the Mann-Elkins Act.[9] As had been the case in the ICC, the pervasive focus of the Congressional hearings,[10] committee reports,[11] and floor debates[12] leading up to the Mann-Elkins Act was on the problem of rate *increases*, and not initial rate filings. The resulting use of the terms "new" and "changed" rate, as distinguished from "initial" rate, cannot be written off as meaningless.

While the Commission has nevertheless occasionally asserted its authority to suspend initial tariffs, the circumstances of those cases illustrate that the suspension power does not extend to initial tariffs of the type now before the

8. Twenty-First Annual Report of the Interstate Commerce Commission 9-10 (1907) (emphasis added). *See also* Twenty-Second Annual Report of the Interstate Commerce Commission 10-12 (1908); Twenty-Third Annual Report of the Interstate Commerce Commission 6-7 (1909).

9. 34 Stat. 589 (1910). *See generally* 1 Sharfman, The Interstate Commerce Commission at 201-02 (1931); Arrow Transportation Co. *v.* Southern Ry., 372 U.S. 658, 662-66 (1963); Hope Natural Gas Co. *v.* FPC, 196 F.2d 803, 806-07 (4th Cir. 1952).

10. *See, e.g.,* Hearings on Bills Affecting Interstate Commerce Before the House Comm. on Interstate and Foreign Commerce, 61st Cong., 2d Sess. 1174, 1268 (1910) (Statements of ICC Commissioners Knapp and Clements).

11. *See, e.g.,* H.R. Rep. No. 923, 61st Cong., 2d Sess. 165 (1910).

12. *See, e.g.,* 45 Cong. Rec. 3446 (1910) (remarks of Sen. Elkins); 45 Cong. Rec. 3373 (1910) (remarks of Rep. Cummins).

Commission. None of the cases cited by the protestants as illustrative of initial tariff suspensions resulted in an order that had the effect of entirely precluding the transportation of the goods.[13] Rather, all of those cases involved initial tariffs that were simply designed to add some new service to the carrier's existing business on the same general route, and indeed, in some of the cases the particular respondent carrier was able to move the goods in an alternative manner.[14]

The significance of these distinctions is that they emphasize the fact recognized by all of the protestants—that a suspension order would be a wholly inappropriate remedy in response to initial tariffs of this sort, where the effect would be to restrain entirely the movement of any North Slope oil, either by these or any other carriers. In fact, none of the protestants has seriously argued that the tariffs here involved should be made subject to an outright seven-month suspension during which no rates would be in effect, and no interstate transportation of the petroleum would be possible.

Rather, they all propose suspension primarily as a device to impose unlawful interim tariffs. In addition, the Bureau views the asserted suspension power as an economic club to be used by the Commission to circumvent the

13. *See, e.g.,* Foodstuffs and Agr. Commodities, Cal., and Ariz., to W. and S.W., 329 I.C.C. 321 (1966); Animal Feed From Miss. and Tenn. to Midwest and S.W., 316 I.C.C. 94 (1962); Barge-Rail Coal From Huntington, W.Va., to Chicago Dist., 315 I.C.C. 129 (1961); Clay From Greybull, Wyo., to Points in the Middle W., 314 I.C.C. 705 (1961); Bituminous Coal Via Motor-Rail From Lynnville, Ind., to Chicago, Ill., 313 I.C.C. 573 (1961); Machinery From Salt Lake City—International Transp., Inc., 304 I.C.C. 286 (1958).

14. Animal Food, Middlewest to Calif., Idaho, and Utah, 332 I.C.C. 87 (1967); Rail-Water, Grain in Bulk, Mo., Ill., and Ind. to Buffalo, 321 I.C.C. 564 (1963); Cotton From New Orleans, 49 I.C.C. 751 (1918).

structure of the Interstate Commerce Act by imposing an unlawful refund provision, as well as to subvert the Commission's Rules of Practice by compelling discovery unauthorized by those Rules. The Commission lacks authority to adopt that approach, and should allow tariffs to go into effect pending an investigation into the lawfulness of the rates.

B. The Commission Lacks Authority to Prescribe Interim Rates Without a Full and Fair Hearing.

Central to the Commission's rate-making scheme is the proposition that rates are to be fixed by the carrier in the first instance. *See, e.g., Arizona Grocery Co.* v. *Atchison, T. & S.F. Ry.*, 284 U.S. 370, 384 (1932); *Hanna Mining Co.* v. *Missouri Pac. R.R.*, 332 I.C.C. 166, 171 (1968). Under Section 15(1) of the Act, 49 U.S.C. § 15(1), the Commission is not itself empowered to prescribe rates, except on review of those established by the carrier, and then only after "full hearing" and a finding that the rate fixed by the carrier "is or will be unjust or unreasonable . . . or otherwise in violation of [the Act]."

The Commission thus cannot prescribe rates (whether denominated "interim" or not) on a summary examination of tariffs or a mere suspicion that they are too high, but rather must afford a full hearing to test the lawfulness of the rates.[15] The Supreme Court has made clear that this

15. At that required hearing, the burden is squarely on the protestants to prove the unlawfulness of the initial rate. As recognized by Alaska and the Bureau, Section 15(7) places the burden of proof on the carrier only where a changed rate, and not an initial rate, is challenged. *See* Bureau Protest at 34-35; Alaska Protest at 19. *See also, e.g.,* Animal Feed from Mississippi and Tennessee to Midwest and Southwest, 319 I.C.C. 257, 259 (1963); Bituminous Coal Via Motor-Rail from Lynnville, Indiana to Chicago, Illinois, 313 I.C.C. 573, 574 (1961). The contrary argument of the Antitrust Division (at 8-9) and ASRC (at 16) is simply wrong.

is not a technical requirement, but a mandate that a truly "ample opportunity is afforded to all parties to make, by evidence and argument, a showing fairly adequate to establish the propriety or impropriety, from the standpoint of justice and law, of the step asked to be taken."[16]

Under Section 15(1), then, the imposition of an interim rate at this time would be unlawful. The skeletal, conclusory submissions to which the Commission now has access can hardly be said to constitute the full record that the statute requires before a rate can be prescribed. Indeed, the Commission is at an even greater disadvantage here than in the ordinary case. The initial tariffs at issue in this proceeding concern a new pipeline, transporting goods over a route previously not available to shippers, and there is no useful closely comparable experience upon which the Commission might draw to arrive at a range of presumptively lawful rates.

In short, given the limited state of its knowledge and the absence of relevant background information, the Commission cannot properly conclude that the initial rates proposed by the carriers are unlawful, and that some other rate can be taken as permissible pending the outcome of an investigation. The imposition of an interim rate at this time would constitute a clear violation of Section 15(1).

C. Suspension With Leave to Refile at A Suggested Rate is Tantamount to a Prohibited Prescription of Rates by the Commission.

Protestants attempt to circumvent the plain dictates of Sections 15(1) and (7) by proposing that the Commission

16. *Akron, C. & Y. Ry.* v. *United States* (The New England Divisions Case), 261 U.S. 184, 200 (1923). *Cf. North Carolina Natural Gas Corp.* v. *United States*, 200 F. Supp. 745, 748-49 (D. Del. 1961) (holding that the entire statutory scheme precludes a summary finding that challenged rates "are unlawful per se and require cancellation".)

suspend the initial rates proposed by the carriers, but grant the carriers leave to cancel their initial tariffs and to file substitute initial tariffs on short notice at suggested lower rates. This approach is a transparent attempt to accomplish indirectly what the Commission cannot do directly—prescribe rates without a full hearing.

The courts have consistently rejected similar attempts to ignore statutory commands that rates are to be initiated by carriers, and are to be revised by the agency only upon a full hearing and a finding that the rates are unlawful. In *Moss* v. *CAB*, 430 F.2d 891 (D.C. Cir. 1970), the major domestic air carriers filed with the Civil Aeronautics Board tariffs that provided for rate increases. After oral argument scheduled on its own motion, the Board found that the tariffs "may be" unlawful and ordered the tariffs suspended and investigated. It further found, however, that the carriers had demonstrated a need for some additional revenue. It, therefore, "outlined its own fare formula and announced its decision to 'permit tariff filings implementing' that formula to be filed without suspension . . . ." 430 F.2d at 894-95. The Board stated that it "would 'be disposed to grant an increase' " which adhered to its plan, *id.* at 896, but warned that rates above the prescribed maximum "would be viewed *prima facie* as outside the realm of justness and reasonableness and would ordinarily be suspended and ordered investigated." *Id.* at 897. The carriers thereafter withdrew their tariffs and substituted new tariffs in accordance with the Board's plan.

On review of the Board's order, the court of appeals reversed. It flatly rejected the Board's contention that because the carriers were not legally bound to refile based on the formula set out in the Board's order, there had been no prescription of rates. The Court characterized this as a "legalistic reading of the statute." *Id.* at 895.

The court went on to conclude that "these rates . . . have been determined by the Board. . . ." *Id.* at 896.

> It would be blinking reality to hold, as the Board argues, that the order of September 12 did no more than suspend and initiate an investigation of the rates proposed by the carriers. . . . The Board did all that it could, short of formally styling its order as rate-making, to induce the carriers to adopt the proposed rates. [430 F.2d at 897-98.]

Subsequent cases have read *Moss* as permitting judicial scrutiny of " 'sham' suspensions aimed at coercing behavior rather than merely preserving the status quo pending investigation." *Continental Airlines* v. *CAB*, 522 F.2d 107, 129 (D.C.Cir. 1975). In *SCRAP* v. *United States*, 346 F. Supp. 189 (D.D.C. 1972) (three-judge court), *rev'd on other grounds*, 412 U.S. 669 (1973), the court stated that "[a] suspension decision which effectively blackmails the carriers into submitting agency-authorized rates is functionally indistinguishable from an agency order setting those rates. . . ." 346 F. Supp. at 197.

The protestants to the initial tariffs here at issue propose an approach indistinguishable from that rejected in *Moss*. The Bureau, for example, requests that the Commission include in its order "special permission . . . to cancel the proposed rates, and to file and to make effective the following rates on not less than one day's notice pending the hearing and decision in the ordered investigation." Bureau Protest at 40. The Bureau then lists a specific rate for each carrier, substantially below those contained in the respective initial tariffs. *Id.* at 41. Incredibly, it argues that *Moss* can be avoided by this approach because (1) the Commission would "include a statement in its order that it is not prescribing rates," and (2) the suggestion of permissible

interim rates "would in no way prejudge the outcome of its investigation of the lower rates." *Id.* at 13. As in *Moss*, 430 F. 2d at 897-98, "[i]t would be blinking reality" to conclude that leave to refile at a specified interim rate would be anything less than the *de facto* prescription of rates by the Commission without a full and fair hearing.

To the contrary, the imposition of "suggested" rates which the carriers would be permitted to put into effect would produce precisely the sort of coercion, with all of the attendant risks, that concerned the *Moss* court. Even more so than in *Moss*, the Commission here would be acting with a nearly total absence of relevant facts. As shown *infra*, the matters that a full investigation and hearing would necessarily inquire into are unusually complex, difficult and novel. Moreover, as noted earlier, the Commission in this case lacks the pool of applicable acquired experience which it has in most matters before it and which the CAB had in *Moss*. Thus, on the present state of the record, the "suggestion" of rates by the Commission would be wholly without basis, and would completely subvert the statutory scheme.

Equally importantly, the suggestion of rates, backed by a threat of suspension of the carriers' proposed rates, would place the carriers in a grossly unfair position. Their only alternatives would be to hold to their initial tariffs, and thereby face a seven-month suspension during which no Alaskan oil would be transported, or to accede to the Commission's "suggested" rates and adopt them as their own. The economic coercion is apparent. *Cf. Consolidated Edison Co.* v. *FPC*, 512 F.2d 1332, 1340-41 (D.C.Cir. 1975). If the Bureau's suggested procedure were invoked, the carrier's discretion to set rates, as guaranteed by the Act, would be "so circumscribed as to [be] almost nonexistent." *National Association of Motor Bus Owners* v. *FCC*, 460 F.2d 561, 567 (D.C.Cir. 1972).

The Bureau asks the Commission to force the carriers to choose between (1) allowing an $8 billion dollar investment to remain idle, thereby delaying the arrival of North Slope oil and the balance of payments benefits that will accompany it, or (2) knuckling under to the economic coercion which the Bureau proposes and agreeing to refile at the lower rate. This procedure would be tantamount to the Commission's prescription of a rate without the requisite full hearing. The Commission would thereby be doing by indirection that which it is plainly forbidden from doing directly, a result which the *Moss* case clearly proscribes.

D. The Commission Lacks Statutory Authority to Impose a Condition for Possible Refunds.

The Bureau urges (Protest at 33-36) that any order permitting interim rates should include a condition providing for possible refunds. Such a condition is beyond the authority of the Commission.[17]

The relevant portion of Section 15(7) is as follows:

> . . . [I]n case of a proposed *increased* rate or charge for or in respect to the transportation of property, the Commission may by order require the interested carrier or carriers to keep accurate account in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts are paid, and upon completion of the hearing and decision may by further order require the interested carrier or carriers to refund, with interest, to the persons in whose behalf such amounts were

17. The Bureau tacitly concedes some doubts on this issue when it states that "the Commission's jurisdiction to order a refund of an initial rate is not clear in the statute." Bureau Protest at 33. Contrary to the Bureau's statement, we submit that the law *is* clear; the Commission's refund power does not extend to initial rates.

> paid, such portion of such increased rates or charges as by its decision shall be found not justified. [Emphasis added.]

By its express terms, the refund authority applies only to "a proposed increased rate or charge," not to an initial rate. This fact was reflected in the statement issued by the ICC's Office of Proceedings on April 18, 1977. That statement, which summarized the procedures to be followed in connection with initial tariffs for TAPS, made no reference to the refund provisions of Section 15(7), but instead observed that any person injured by unlawful rates could seek reparations or damages under Sections 8, 9, 13 and 16 of the Act.

Reference to the analogous provision in Section 204 of the Communications Act of 1934, 47 U.S.C. § 204, as amended, is also instructive. Like the Interstate Commerce Act, the Communications Act as originally enacted provided for a refund "in case of a proposed increased charge."[18] In 1976, Section 204 was amended to make the refund provision applicable "in case of a proposed charge *for a new service* or an increased charge" (emphasis added).[19] The legislative history of the amendment makes clear that in the view of the Congress, the earlier language, which mirrors that of Section 15(7) of the Interstate Commerce Act, was applicable only in rate increase situations, and that the change was made to extend the power of the Commission specifically to tariffs involving charges for a new service.[20] The Interstate Commerce Act was amended

18. Act of June 19, 1934, c. 652, Title II, § 204, 48 Stat. 1071.

19. Act of Aug. 4, 1976, Pub. L. 94-376, § 2, 90 Stat. 1080.

20. H. Rep. No. 94-1315, 94th Cong., 2d Sess. (1976), pp. 4-6, 15-16, 3 U.S. Cong. & Adm. News (1976), pp. 1929-30, 1936-37.

extensively the same year,[21] but the comparable refund provision was not similarly broadened.

The Bureau seeks to bootstrap its way to refund authority by contending that a refund condition is "tantamount to the exercise of express statutory authority to grant reparation." (Protest at 34). It suffices to point out that refunds and reparations are separate remedies, involving different statutory bases and different procedures, and the existence of one is not relevant to the existence of the other.

The cases cited by the Bureau are not pertinent. The *Chesapeake & Ohio* case referred to on page 34 did not involve refunds in any way. The procedure utilized in the *Admiral-Merchants Motor Freight* case was upheld by the district court in the peculiar circumstances of that case, under the doctrines of equitable estoppel and "binding waiver" of the right to object, and where the posture of the carriers was regarded as "grossly inequitable." But the court added that the Commission's imposition of a refund condition in a situation where refunds were not expressly authorized by statute is a procedure which "we do not commend . . . as one which *should be or could be* practiced." 321 F. Supp. 353, 360 (D. Colo.), *aff'd*, 404 U.S. 802 (1971) (emphasis added). A conditional order aimed at forcing the carriers to agree "voluntarily" to a refund procedure is not a cure for the Commission's absence of statutory authority.

F. The Request for Documentary Discovery as a Condition to a Tariff Filing Is Contrary to the Commission's Regulations.

The Bureau would impose yet another unlawful condition on respondents by requiring that in addition to filing a

21. Railroad Regulatory Reform Act of 1976, Act of Feb. 5, 1976, Pub. L. 94-210, Title II, § 202(e)(1), 90 Stat. 31, 36.

suggested interim rate they agree to comply with an extensive documentary demand. Bureau Protest at 8-11. By so requesting, the Bureau seeks to free itself from complying with the rules governing practice before the ICC.

Rule 66 of the current Commission Rules of Practice, 49 C.F.R. § 1100.66, provides that:

> Upon petition by any party and upon good cause shown, the Commission may issue an order and direct any party . . . to produce and permit the petitioning party to inspect any designated documents . . . which constitute or contain matters within the scope of § 1100.57 . . . .

Rule 57(a) in turn limits the availability of discovery to "any matter, not privileged, which is relevant to the subject matter involved in the pending proceeding." 49 C.F.R. § 1100.57(a). This framework thus requires a party seeking documentary discovery in an investigation of tariffs to petition the Commission and to demonstrate the relevance of the materials sought.[22]

The Bureau's proposal, however, would avoid this regulatory scheme and would have massive, poorly-conceived and exceptionally burdensome discovery ordered, with no showing of need or relevance. The Bureau, moreover, would force the carriers to forego their objections to that request, however legitimate, and effectively to become parties to that discovery request by requiring their advance consent to the demand as a condition to filing for interim rates. The Bureau cites no authority for this steamroller approach to deny parties their proper discovery procedures, and none exists.

22. The revised rules scheduled to take effect July 1, 1977, 42 Fed. Reg. 23806 (May 11, 1977), do not alter this procedure. See new rules 55 and 64, 42 Fed. Reg. at 23815, 23817-18.

While ARCO Pipe Line will not here respond in detail to the merits of the discovery request,[23] or to the Bureau's allegations, it is appropriate to note that the document demand contained in Appendix D to the Bureau Protest casts serious doubt on the Bureau's independent discovery needs. That request is a virtual reproduction of a document demand served upon the carriers by the Alaska Pipeline Commission on April 8, 1977.[24] This reliance on the discovery request of another party in another proceeding directly points out the wisdom of requiring the Bureau to establish its need for and entitlement to the documents.

Simply stated, the Bureau should be held to the requirements of the Commission's discovery rules. Those rules dictate that the party seeking discovery show that the documents sought are relevant to the proceeding and are otherwise discoverable, and that such party has a legitimate need

23. It should be noted, however, that the request is extraordinarily burdensome and unreasonable. The request makes no attempt at particularity; instead, its specifications seek "all documents relating or referring to" various general subjects, or "all documents in the nature of" various categories of materials. Many of the subjects or categories are so general that it may be impossible to determine which documents are responsive. For example, specification 19 seeks:

> To the extent not specified above, all documents prepared by or on behalf of the Company, or received by the Company, that relate or refer to cost forecasts, projections, estimates, or expenditures incurred with regard to the costs associated with TAPS.

In order to comply with the document request, the carriers would have to search thousands of files in numerous locations to attempt to identify responsive documents. On top of this, the Bureau requests that production be made within 30 days. If compliance with the proposed request is possible at all, it is certainly not possible within 30 days.

24. *See* Appendix G to this Response. The owner companies objected, *inter alia,* to the scope and return dates of the subpoenas. Negotiations with respect to these matters are continuing.

for the documents in connection with its participation in the proceeding. The proper means for making that showing is through a discovery petition, and not as a condition to a tariff filing.

In *Pacific Molasses Co.* v. *FTC*, 356 F.2d 386, 389-90 (5th Cir. 1966), the court stated:

> When an administrative agency promulgates rules to govern its proceedings, these rules must be scrupulously observed . . . . For once an agency exercises its discretion and creates the procedural rules under which it desires to have its actions judged, it denies itself the right to violate these rules. [Citations omitted.]

That rule applies perforce to an entity of an administrative agency. The Bureau's approach seeks to circumvent the Commission's discovery rules. If adopted, it would also effectively preclude impartial supervision of the discovery process by the Commissioner or Administrative Law Judge designated to preside over any investigation which may be ordered. It should be flatly rejected.

While ARCO Pipe Line strongly resents the unlawful coercive approach urged by the Bureau, it wishes to assure the Commission of its willingness to cooperate in furnishing documentary and other information within the scope of any investigation which may be ordered, utilizing voluntary means rather than compulsory process to the maximum extent possible. Alyeska has, since late 1976, been devoting intensive efforts to cooperating with the Commission and its accounting consultant, on a wholly voluntary basis. The result has been the production of more than 130,000 pages of documents in either hard copy or microform and the holding of 74 interviews of Alyeska personnel. Another

130,000 document pages have been made available to Touche Ross, and recently, Touche Ross, acting on behalf of the Commission, has been conducting an average of 25 interviews a week. As these activities indicate, the carriers are willing and anxious to make available all of the relevant facts dealing with the construction of the pipeline. This willingness to cooperate should not be confused with condoning a circumvention by the Commission of the rules designed to assure fair and orderly discovery.

II. The Proposed Initial Tariffs Should be Allowed to Go Into Effect.

The preceding arguments are addressed to the question of whether the Commission has the *power* to grant the relief requested by protestants. But even assuming *arguendo* that such power exists, there are important reasons why the Commission should not exercise that power in this situation.

A. The Rights of All Parties Can Be Adequately Protected Only By Permitting the Tariffs to Become Effective.

In essence, there are only two courses of action being urged upon the Commission. The protestants argue that the Commission should suspend the proposed rates and force the carriers to adopt lower rates. The carriers contend that the proposed rates should be permitted to go into effect, subject to the Commission's right to require adjustment of those rates if it later determines, after full hearing, that the rates are unreasonable.

The first alternative—that advanced by protestants—could result in irreparable harm to the carriers. Where a carrier fails to realize adequate revenues during a period,

whether such failure results from economic circumstances, a suspension of rates, or a forced reduction of rates to an unreasonably low level, it is well established that the carrier cannot recoup the losses or lost profits, either through a surcharge to customers who have used its services under the tariff, or through future rates which are higher than those otherwise justified.[25]

"It is, of course, a cardinal principle of ratemaking that a utility may not set rates to recoup past losses, nor may the Commission prescribe rates on that principle."[26] Likewise, under none of the provisions of the Interstate Commerce Act ". . . has it ever been the rule that increased rates allowed after a period of suspension could be made retroactive during that period. . . . [S]ubsequent orders allowing increased rates are given only prospective operation."[27]

On the other hand, if the Commission allows ARCO Pipe Line's proposed rates to go into effect, shippers will be protected by the reparation provisions of Section 8 of the Interstate Commerce Act.[28] The reparation provision establishes the liability of the carrier, with respect to any violations of the Interstate Commerce Act, "to the person or persons injured thereby for the full amount of damages

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25. *See, e.g.*, Galveston Electric Co. *v.* City of Galveston, 258 U.S. 388, 395 (1922); FPC *v.* Natural Gas Pipeline Co., 315 U.S. 575, 590 (1942); Communications Satellite Corp., 57 F.C.C. 2d 571, 575 (1976); AT&T *v.* FCC, 487 F.2d 865 (2d Cir. 1973); Prendergast *v.* New York Telephone Co., 262 U.S. 43 (1923); Arizona Grocery Co. *v.* Atchison, T. & S.F. Ry. Co., 284 U.S. 370, 387-88 (1932).

26. Nader *v.* FCC, 520 F.2d 182, 202 (1975). *See also,* United States *v.* SCRAP, 412 U.S. 669, 696 (1973).

27. Hope Natural Gas Co. *v.* FPC, 196 F.2d 803, 807 (4th Cir. 1952).

28. 49 U.S.C. § 8.

sustained in consequence of any such violation." That provision applies even though there is no refund power with respect to initial rates.[29] Pursuant to Section 9 of the Act, 49 U.S.C. § 9, any person claiming damage may elect between filing a complaint before the Commission and filing a complaint in a United States district court. If any complaint is made to the Commission pursuant to Section 13 of the Act, Section 16 then directs the Commission to determine entitlement to damages and to direct the carrier to pay any damages assessed, the Commission's order thereafter being subject to enforcement in either a United States district court or a state court.[30]

Under the Act, the Commission has the power to award reparations to shippers injured by unreasonable charges.[31] The question of the reasonableness of a rate is a matter within the primary jurisdiction of the Commission,[32] and it is well settled that the power and duty over rate-making is vested in the Commission alone. Thus, the court will not substitute its judgment for that of the Commission where

29. *See* Section I.D., *supra*.

30. To the extent damages are to include interest, Section 202(e) of the Railroad Revitalization and Regulatory Reform Act of 1976, Pub. L. No. 94-210, 90 Stat. 31, provides a useful guide to the setting of an appropriate interest rate. That Act specifies that if the Commission shall order refunds for what it finds to be an unlawful increased rate, interest shall be computed "at a rate which is equal to the average yield (on the date such schedule is filed) of marketable securities of the United States which have a duration of 90 days." 49 U.S.C. § 15(8)(e). This provision constitutes the most recent congressional statement on this subject in the context of the Interstate Commerce Act. The Bureau's request for a 9% interest rate, Bureau Protest at 36, and ASRC's alternative interest formulations, ASRC Protest at 19, are based on no authority whatsoever and should be disregarded.

31. Nader *v.* FCC, *supra*, 520 F.2d at 203 n.22.

32. United States *v.* ICC, 337 U.S. 426, 437 (1949).

the Commission's judgment is based on substantial evidence taken in due course.[33]

Of course, the only protestants asserting an economic stake in the level of ARCO Pipe Line's tariff are the State of Alaska and ASRC. ASRC's stake is derivative of the State of Alaska's royalty interest, since payments to the fund in which ASRC is entitled to share come from a portion of the State's one-eighth royalty interest in all North Slope oil produced. In essence, ASRC's concern is merely in the timing of payments, and not their total amount, since a ceiling on the fund is set by the Alaska Native Claims Settlement Act. *See* ASRC Protest at 6. Since only a matter of timing is involved, ASRC's concern with maximizing its monetary stake can be met by the expeditious disposition by the Commission of any investigation it may choose to order. Similarly, ASRC's asserted interest in possible future leases of its lands or sale of oil that may be found thereon can also be protected by such disposition.

With respect to the State, it might be well to note at the outset that Alaska does not seek outright suspension, for reasons which are fully understandable. As Appendix A to this Response indicates, Alaska stands to gain enormous tax revenues from the production and transportation of North Slope oil. During the period from September 1, 1977 through December 31, 1981, ARCO Pipe Line alone expects to pay out more than $260 million in Alaska Gross Receipts, *ad valorem* and income taxes. Assuming a proportionate level of payments by other carriers, these taxes upon the carriers alone would amount to approximately $1.3 billion during this period. In addition, Alaska has a significant severance tax upon oil produced, a tax which

33. City of Danville *v.* Chesapeake & Ohio Ry., 34 F. Supp. 620, 625 (W.D. Va. 1940).

was recently increased by approximately 50 percent to a rate of 12.25 percent. Thus, while the State claims to be suffering significant economic injury, it has unilaterally increased its severance tax take in an amount which, at an assumed wellhead value of $6.55 a barrel,[34] would produce an additional $93 million a year in revenue at a production rate of 1.2 million barrels a day. It is therefore apparent that the State's interests would be severely injured if TAPS did not go into operation as scheduled.

Finally, the state has a one-eighth royalty interest in all oil produced; at a production rate of 1.2 million barrels a day and an assumed wellhead value of $6.55 (see note 34, *supra* at 31), this amounts to more than $350 million annually.

The State's interests in the level of tariffs has several aspects. First, it may be a shipper of oil which it takes in kind pursuant to its royalty rights. Any damage to its interests as a shipper can clearly be remedied by a reparations proceeding pursuant to Sections 8 and 9 of the Interstate Commerce Act.

Second, the State has an interest as the seller of oil taken in kind. It can protect that interest in at least two ways: (1) by selling its oil at Valdez, so that it is the shipper entitled to any reparations which may be awarded, or (2) by including in its contracts for sale of oil at the wellhead a provision entitling it to recapture the amount of

34. The starting point for this figure is $13.50, the landed price at Los Angeles for imported sour crude as adjusted downward for a quality differential. This is the figure that the FEA has most recently indicated it intends to set as a West Coast market price for Alaska North Slope oil. Subtracting from that figure $.70 for tanker transportation between Valdez and the West Coast, $.05 for contributions to the TAPS System Liability Fund, and $6.20 for the average TAPS transportation tariff, an estimated wellhead value of $6.55 results. ASRC's assumption that the wellhead value will be in the range of $4.25, ASRC Protest at 17, is simply wide of the mark.

any reparations to which the purchaser becomes entitled if the transportation rate is ultimately reduced.

Third, the State has an interest in the amount of severance tax which it receives, and that tax is related to the wellhead value of the oil, which in turn is affected by the amount of the pipeline tariffs. It would appear that the State's remedy with respect to its severance tax interest lies with the enforcement of provisions of state law respecting the collection of the tax. The Alaska Department of Revenue has powers with respect to challenging the value assigned to produced oil (see Alaska Stat. § 43.55.050 (1971)). A period of three years is available to the Department if it wishes to initiate assessment proceedings relating to the severance tax. Alaska Stat. § 43.05.260 (Supp. 1976).

In short, it appears that the State's interest as royalty holder benefits from substantial protection afforded by the reparations procedure, assuming that it takes prudent steps to bring itself within those protections. The State's severance tax interests appear to be adequately protected under state law, provided that this Commission expeditiously concludes any investigation which it may order and any related reparations proceeding. ARCO Pipe Line, on the other hand, for the reasons set forth above, is wholly unprotected if its tariff is initially understated. In these circumstances, equity clearly favors allowing the tariff to become effective as scheduled.

B. The Challenges to the Rate in ARCO Pipe Line's Tariff Cannot Properly Be Resolved in a Suspension Proceeding.

Apart from the urging of unlawful procedures upon the Commission, the major defect in the approach advanced by all protestants is the suggestion that the Commission reject ARCO Pipe Line's tariff, derived in accordance with

longstanding ICC valuation and rate-of-return methodology, and substitute in its stead a wholly new approach which has not been subjected to scrutiny by the Commission or its staff and which has major and obvious conceptual flaws. This course of action should be rejected for a number of reasons. First, the ARCO Pipe Line tariff has been derived strictly in accordance with existing ICC methodology; protestants are incorrect in asserting that such methodology does not allow the deduction of interest as an expense, since the ICC has as recently as 1976 furnished the Congress with detailed rate-of-return-on-valuation statistics which demonstrate beyond a possible doubt that the statistics were based on the deduction of interest as an expense (*see* pages 35-39, *infra*). Second, the very methodological issues involved are the subject of a major rulemaking proceeding, Ex Parte No. 308, and the Commission has itself recently said that even a full-blown tariff investigation proceeding is not a suitable forum for examining proposed new methodology when that proceeding relates to individual tariff rates; it is clear that the issues raised by protestants cannot receive meaningful consideration, much less resolution, in a summary proceeding in which the sole question is whether or not to suspend (*see* pages 39-43, *infra*). Third, even if one were to accept the basic methodological assumptions of protestants, they have applied their methodology in a demonstrably unsound way in an effort to distort the true rate of return earned under their methods; rather than producing rates of return in the range of 56 percent to 100 percent as claimed by protestants, any proper application of their methodology would produce a rate of return for ARCO Pipe Line on the order

of 13.5 percent, well within accepted observed ranges for rate of return (*see* pages 44-51, *infra*).

1. ARCO Pipe Line's Tariff Is Established in Accordance With Existing ICC Methodology.

Appendix A to this Response describes in detail the procedures used in computing the rate of $6.04 per barrel set forth in the ARCO Pipe Line tariff. A comparison of Appendix A with the Verified Statement of Jesse C. Oak, Senior Valuation Engineer, of the ICC Bureau of Accounts, submitted in Ex Parte No. 308 for the express purpose of describing ICC pipeline valuation methodology, will demonstrate that ARCO Pipe Line's tariff is constructed in accordance with existing ICC valuation methodology.

We do not understand any protestant to contend that the situation is otherwise. With respect to application of existing methodology, the sole issue raised by the Bureau and the State of Alaska is that treating interest as an expense in calculating allowable rate of return on valuation is contrary to ICC practice. Their contentions are erroneous; in treating interest as an expense, ARCO Pipe Line has followed a course well-understood and long accepted by the ICC.

The most celebrated Supreme Court case involving rates of return for oil pipelines is *United States* v. *Atlantic Refining Co.*, 360 U.S. 19 (1959). The parties to that case were 13 oil companies and pipeline companies. They included affiliates or predecessors in interest of five of the respondents or their corporate parents. The case was a major attack upon the method used by the companies to determine the dividends which a pipeline subsidiary could lawfully pay to a corporate parent which was a shipper on

the pipeline, under the terms of the so-called Pipeline Consent Decree.[35]

The Pipeline Consent Decree had made ICC valuation a central factor in calculating the allowable rate of dividends. The process for measuring allowable dividends under the consent decree, subject to the seven percent ceiling imposed by the decree, was therefore substantially the same as that for measuring allowable return on valuation under the eight percent limitation imposed upon crude oil pipelines by roughly contemporaneous ICC cases.[36]

The *Atlantic Refining* case is significant because of the interpretations placed upon it by the ICC. The ICC has obviously been aware that pipelines are frequently financed with a high percentage of debt appearing on the books of the pipeline subsidiary. If ICC methodology did not treat interest as an expense, then the ICC-imposed eight percent return limitation would have been a much more severe limitation than the seven percent dividend-payment limitation imposed by the consent decree, and the consent decree would have been largely irrelevant for any pipeline financed with a high debt-equity ratio. Yet testifying before a congressional committee in 1972, then-Commission Chairman Stafford and several ICC staff personnel directly involved in the regulation of pipelines emphasized the effectiveness of the consent decree in controlling the returns to pipeline

35. United States *v.* Atlantic Refining Co., Civil Action No. 14060 (D.D.C., December 23, 1941). In view of the Pipeline Consent Decree, and United States *v.* Atlantic Refining Co., *supra* at 35, the propriety of the Antitrust Division relitigating, in effect, before the ICC the battle which it lost in the Supreme Court in 1959 appears doubtful. This question obviously cannot be addressed in the summary proceeding.

36. Minnelusa Oil Corp. *v.* Continental Pipeline Co., 258 I.C.C. 41, 54 (1944); Reduced Pipe Line Rates and Gathering Charges, 243 I.C.C. 115, 143 (1940).

companies.[37] Their entire testimony was premised on the direct comparability between the dividend rate allowable under the consent decree and the rate of return on valuation allowed for ICC purposes. Hence this testimony clearly demonstrates that the ICC considered interest as an element of expense in applying ICC rate-of-return limitations.

Subsequent ICC submissions to the Congress have rested on similar assumptions concerning interest as an allowable expense. On November 10, 1975, Chairman Stafford furnished information to a subcommittee of the House Small Business Committee in response to pointed questions on pipeline rates of return. Included in the response to the Subcommittee's Question 5 were detailed summary tables captioned "Oil Pipeline Companies—Rates of Return on Valuation." Those tables are included in Appendix B.

In March of 1976, Chairman Stafford discovered that some errors had been made in the 1975 submission, and furnished the congressional committee chairman, Mr. Hungate, with corrected versions of certain of the tables. A copy of his transmittal letter and the corrected tables are also included in Appendix B.

In order to determine definitively the basis for the rate of return calculations used by Chairman Stafford in the 1976 figures furnished to Congress, Mr. John Jeter, a partner in the independent accounting firm of Arthur Andersen & Co., had calculations made under his supervision, based on the Form P Annual Reports to the ICC, for a number of pipeline companies. A detailed description of the calculations

37. Anticompetitive Impact of Oil Company Ownership of Petroleum Products Pipelines: Hearings Before the Subcommittee on Special Small Business Problems of the House Select Committee on Small Business, 92nd Cong., 2d Sess., at 77, 84-89, 94-95 (1972).

is found in Mr. Jeter's verified statement regarding the treatment of interest as an operating expense, Appendix C.

Mr. Jeter's conclusion is both significant and dispositive on the question of interest being allowed as an expense in calculating rate of return on valuation under existing ICC methodology: *He found that in every instance with respect to the companies whose Form P's were examined, the data furnished to Chairman Hungate by Chairman Stafford was based on allowance of interest as a deduction in calculating the rate of return on valuation figure.*

These calculations of rate of return on valuation by the ICC are the strongest possible indication as to current ICC methodology with respect to the deduction of interest. They are certainly much more current, and more authoritative than the 1935 figures on which the Bureau relies to support its contention that interest is not deductible as an expense in determining rate of return on valuation.[38]

Based on the consistent history of interpretation of its own methodology by the ICC, ARCO Pipe Line's treatment of interest as an expense constitutes application of accepted ICC methodology. Protestants' contrary suggestion is simply wrong.

2. Changes In Methodology Are Not Appropriate In this Suspension Proceeding.

The rates proposed by protestants are based upon changes in the existing ICC valuation and rate of return methodology. Such changes can only be dealt with in a rule-making proceeding, carried out pursuant to the Administrative Procedure Act, in which all interested parties have an opportunity to present their views and any information they deem relevant. It is inappropriate to consider those

38. Bureau Protest at 28-29.

changes in any proceeding involving the tariffs of individual carriers.[39] It is singularly inappropriate to do so in the context of a suspension proceeding, where no evidence is presented, where the parties and the Commission are operating under a restricted time schedule, and where the sole focus is, or at least should be, on whether or not to suspend.

Moreover, there is currently pending a rule-making proceeding which encompasses most, if not all, of the methodological issues raised by protestants. That proceeding, Ex Parte No. 308, *Valuation of Common Carrier Pipe Lines,* was initiated by the Commision in 1974 to examine the Commission's methodology for determining valuation for pipelines. It was later expanded in scope, for the purpose of reconsidering the authorized rate of return. Despite protestants' suggestions to the contrary, Ex Parte No. 308 is actively progressing. Indeed, within the last two months, lengthy statements of position and data have been filed by numerous parties, including the Department of Justice, representatives of the ICC Bureau of Investigations and Enforcement, the State of Alaska, the Association of Oil Pipe Lines, the Midcontinent Petroleum Prod-

39. Tracing the requests of the protestants through to their logical conclusion points up the impropriety of their approach. Assuming *arguendo* that protestants were to prevail and the Commission were to alter its methodology in determining TAPS valuation and allowable rate of return, one of two courses of action would be possible. If the changes were made applicable only to TAPS owners, the Commission would be treating them differently than other carriers, in violation of the Interstate Commerce Act and the Fifth Amendment of the U.S. Constitution. But if the Commission were to attempt to extend the changes to other carriers, those carriers could complain that they were deprived of any opportunity to participate in the process which produced the changes, in violation of the Commission's rules and the Administrative Procedure Act. Either way, the result is untenable. Clearly a general rule-making proceeding is the only appropriate vehicle for considering methodological changes.

ucts Shippers (a complainant/protestant in *Williams Brothers, infra*), the Williams Pipe Line Company (the successor to the Williams Brothers Pipe Line Company), and other shippers and pipeline companies. A hearing has been scheduled for August 16, 1977 for the purpose of cross-examining witnesses.

The methodological issues raised by protestants are within the scope of Ex Parte No. 308 and should be pursued there. The impropriety of pursuing such issues in proceedings involving individual pipelines has been recognized by the Commission in *Petroleum Products, Williams Brothers Pipe Line Company ("Williams Brothers")*, Docket No. 35533 (Dec. 3, 1976).[40] In that case, the protestants/complainants[41] unsuccessfully presented a number of methodological issues, including several of the ones raised by protestants here. They attacked the use of valuation as a rate base, opposed the inclusion of certain property in the valuation rate base, urged modification of the weight given certain costs in the valuation formula, and asked the Commission to lower the rate of return guidelines for petroleum pipelines.

The presiding judge found the proposed increased rates just and reasonable and the proposed initial joint rates not unlawful (Initial Decision, June 19, 1974). In so doing, he wrote:

> . . . The matter of defects in the Commission's valuation process raised by the Shipper Group has no place here. The valuation process pursuant to section 19a has been employed by the Commission for many years and on railroad and pipeline valuations has withstood many challenges. Any questions involving the valuation process should be determined in a rule-making proceeding at which all affected persons are allowed to present their views. [At 18.]

40. *See also* American Commercial Lines, Inc. *v.* Louisville & N.R.R., 392 U.S. 571 (1968). There the Court endorsed the ICC's decision to deal with complex costing issues in an ongoing rulemaking proceeding rather than in a narrowly focused action concerned with the specific rate reduction of a group of railroads. The Court described the rulemaking proceeding as "a more suitable context" for resolving broad-scale issues. 392 U.S. at 592.

Upon exceptions of various shippers, the ultimate conclusions of the Administrative Law Judge were adopted by Division 2 (351 I.C.C. 102, November 5, 1975). In commenting upon the shippers' exceptions regarding valuation methodology, Division 2 noted:

> In Ex Parte No. 308, the Commission will address itself to each of the seven elements it considers in the development of a valuation. These are (1) original cost, (2) cost of reproduction new, (3) cost of reproduction new less depreciation, (4) going concern value, (5) present value of land, (6) present value of rights-of-way, and (7) working capital. Since the Commission applies the same procedures equally to all pipeline carriers under its jurisdiction, there is no reason to single out one carrier and apply different procedures. If the Commission should elect to change its methodology of performing valuations in Ex Parte No. 308, the new methodology will be applied to all carriers equally and on the same basis. [351 I.C.C. at 112.]

41. Docket No. 35533 was a proceeding consolidating (1) several protests to increased rates that resulted in investigation but not suspension, (2) a complaint against those rates, and (3) a fourth-section application by the shippers regarding certain of those rates.

On reconsideration, the Commission essentially affirmed the ultimate conclusions reached by Division 2 and the presiding judge and stated:

> . . . Questions have been raised in this proceeding both as to whether the carrier's valuation is the proper rate base, and as to what rate of return should be permitted.
>
> • • •
>
> We conclude that the Commission's valuation of WBPL's properties is the proper rate base to be employed in this proceeding. . . . Considerations of consistency and fairness require that we adhere to our previously recognized criteria in investigating the rates of particular pipelines at the present time.
>
> • • •
>
> The technique employed by the Commission in making its valuations was discussed in the Division's report. As the Division found, this is not the proceeding for considering a change in the valuation methods. Such questions will be dealt with in the pending rulemaking proceeding in Ex Parte No. 308, *Valuation of Common Carrier Pipelines.* [At 6-18.][42]

The approach taken by the Commission in the *Williams Brothers* case is plainly correct. The same approach should be taken here.

3. Protestants' Rate of Return Assumptions Reflect Wholly Incorrect Economic Principles.

As the discussion above indicates, it is the position of ARCO Pipe Line that deviations from accepted ICC

42. The Commission's decision in Docket No. 35533 is currently on appeal in the United States Court of Appeals for the District of Columbia Circuit *sub nom. Farmers' Union Central Exch., et al.* v. *ICC,* No. 76-2138.

methodology cannot as a matter of law and should not as a matter of policy be undertaken in the context of a summary suspension proceeding of this kind. Protestants, however, have urged just such an improper course of action, and have accompanied their contentions with a variety of calculations which purport to show that the carriers, including ARCO Pipe Line, would derive exorbitant rates of return if the tariffs as filed were allowed to go into effect. The Bureau, for example, calculates that, for pipeline companies with a debt/equity ratio of 93%/7%, the effective rate of return on equity at seven percent of valuation would be 100 percent.[43] The Antitrust Division asserts that, at a debt/equity ratio of 90%/10%, the ARCO Pipe Line tariff would produce a rate of return of 58.6 percent.[44] The State of Alaska's "expert" witness, in a statement attached to the State's protest, calculates ARCO Pipe Line's "profit rate on equity" to be 66 percent.[45]

These statements are irresponsible and obviously designed to persuade the Commission that some outrageous return is to be realized by the TAPS owner companies. Protestants apparently hope that the Commission, faced with the demanding time constraints of the suspension proceeding schedule and with little opportunity to evaluate the soundness of the calculations which are being advanced, can be stampeded into effectively prescribing an unjustly low rate for the transportation of oil through TAPS.

Even recognizing the advocate's role of the State of Alaska, ARCO Pipe Line is disappointed that the State would utilize profit rate figures so deliberately misleading and calculated to prejudice the Commission in its deliberations. However, it is even more disappointing to find two

43. Bureau Protest at 32.
44. Antitrust Division Protest at 4.
45. Ileo Statement at 1.

agencies of the Federal Government, the Antitrust Division and the Bureau, whose economic interests are not at stake, engaging in a similar use of misleading rate of return data. While the individuals responsible for preparing the protests of the Division and the Bureau may not be versed in the principles of rate of return calculation, both agencies have access to expert economic advice, which they apparently have not utilized.

The central theoretical underpinning of the Bureau, Antitrust Division and State of Alaska calculations of rate of return is the concept that return should be limited to actual costs with respect to the debt portion of ARCO Pipe Line, and a positive rate of return should be allowed only on the equity portion. This is contrary to established ICC methodology, and of course such a major alteration in methodology should not be undertaken in a summary suspension proceeding. But, putting aside for the sake of argument the inappropriateness of making such an alteration at this time, there is a monumental defect in protestants' application of their own theory, rendering all of their rate of return calculations wholly meaningless: What all of the protestants' rate of return calculations either overlook or deliberately fail to mention is that in order to finance the debt which is carried on the books of ARCO Pipe Line, it was necessary for the parent company, Atlantic Richfield Company, to guarantee *every penny* of the debt incurred by ARCO Pipe Line in connection with construction of TAPS. It is true that ARCO Pipe Line has a very high debt/equity ratio. But it is also true that *such a ratio could never be sustained by ARCO Pipe Line as a separate enterprise whose creditors looked solely to the assets of the pipeline company for satisfaction of their claims.* In such circumstances, it is wholly specious to

make rate of return calculations based on the capital structure of the pipeline company alone; the entire enterprise is made possible by the capital structure and credit of the parent company which are pledged in satisfaction of the ARCO Pipe Line debt.

In short, projects such as TAPS are possible only because the parent companies lend their credit to pipeline subsidiaries. Absent such credit, no investor in his right mind would have purchased the notes or bonds of ARCO Pipe Line at the interest rates at which they were offered. Indeed, it is doubtful that they could have been sold at any interest rate.

The fact that, in situations such as are presented here, the relevant capital structure for rate of return calculations is that of the consolidated enterprise, not that of the pipeline subsidiary, is attested to by the verified statements of an experienced investment banker, Mr. Robert L. Huston, a Senior Vice President of White, Weld & Co., Inc., Appendix D. It is further supported by the verified statement of Dr. J. Rhoads Foster, who has 40 years' experience in rate of return methodology, Appendix E. Both Mr. Huston[46] and Dr. Foster[47] make it quite clear that it is absurd to base rate of return calculations on the capital structure of a company such as ARCO Pipe Line, under the circumstances present in the case of TAPS, where Atlantic Richfield Company has guaranteed all of the debt. They express the view that the relevant capital structure is that of the consolidated enterprise.

The only expert opinion adduced in support of any protestant's rate of return calculations is that of Dr. Ileo, in support of the State of Alaska protest. Yet in another context, appearing recently as an expert witness for the

46. Appendix D at 3-5.
47. Appendix E at 6-7.

staff of the Alaska Pipeline Commission, Dr. Ileo expressed views in total accord with those of Dr. Foster and Mr. Huston. Dr. Ileo was testifying as a consultant in a proceeding concerning a proposed intrastate tariff filed by Nikiski Alaska Pipeline Company ("Nikiski"), a wholly-owned subsidiary of Tesoro Petroleum Corporation ("Tesoro").[48] Like many pipeline subsidiaries, Nikiski has a considerably higher debt/equity ratio than its parent. In his testimony before the APC, Dr. Ileo discussed the debt/equity issue as follows:

> [I]t would be incorrect in my judgment to treat Nikiski as if it were an independent company as long as it is wholly owned by Tesoro. This is the case because all of the capital of Nikiski is raised by Tesoro. Moreover, despite the fact that Nikiski appears to be nearly 100% debt financed by Tesoro, it is truly financed by the consolidated capital structure of Tesoro just as any wholly owned operating subsidiary of Tesoro. The fact that Nikiski would never have been constructed without the financial backing of Tesoro, as reflected in the testimony of Nikiski, clearly reflects this situation.[49]

In short, the only expert witness who has provided a statement in support of any protestant's efforts to bring about a change in ICC methodology has given testimony, a mere three months ago, appearing as a witness for an agency of the State of Alaska, which wholly undercuts his own rate of return calculations in support of the Alaska protest. Of course, his earlier testimony also destroys the

48. Alaska Pipeline Commission, Docket Nos. p-76-3 and p-77-3.

49. Testimony of Michael J. Ileo in Alaska Pipeline Commission Docket Nos. p-76-3 and p-77-3, March 14, 1977, at 61-63.

basis of the calculations used by the Bureau and the Antitrust Division as well.

ARCO Pipe Line reiterates the view that this is not the proper proceeding to be considering these areas of rate of return theory. As Dr. Foster indicates in his statement, such matters deserve careful scrutiny in a comprehensive and adequate proceeding.[50] However, because protestants have charged ARCO Pipe Line with earning highly excessive rates of return, the company has asked the independent accounting firm of Arthur Andersen & Co. to calculate rates of return in a manner generally consistent with the views expressed by Dr. Foster and Mr. Huston, utilizing the capital structure of Atlantic Richfield and its subsidiaries on a consolidated basis, and assuming the same tariff rate ($6.04 per barrel) reflected in the pending ARCO Pipe Line tariff.

As is outlined in the verified statement of John A. Jeter regarding return on equity, Appendix F, Mr. Jeter first applied Atlantic Richfield's percentage of debt, 36.4%, to the book value of ARCO Pipe Line's investment in TAPS. The resulting debt figure was then subtracted from estimated ICC valuation to obtain an equity figure. Using the resulting equity figure, and also using the anticipated revenues available for interest, income taxes, and net income, a rate of return was calculated based on the proposed $6.04 rate. As is set forth in Appendix F, the resulting rate of return on equity for 1978, the first full year of operation, is 12.2%; and for the period from September 1, 1977, to December 31, 1981 (the averaging period used in deriving the $6.04 tariff), is a weighted average of 13.4%.

To facilitate comparisons, Mr. Jeter also computed rates of return on equity in the same manner, but using book value rather than ICC valuation to obtain equity figures.

50. Appendix E at 5.

As is set forth in Appendix F, these computations show a return on book equity in 1978 of 13.1%; and for the period September 1, 1978, to December 31, 1981, a weighted average return on book equity of 15.2%.

These figures are, of course, a far cry from the rate of return figures which the protestants would have the Commission believe are to be earned on investments in TAPS. It should be clear that the presentations made by the protestants, ignoring as they do the economic realities of the financing arrangements for TAPS, are seriously misleading and prejudicial. It should also be clear that the rates of return on book equity calculated by Mr. Jeter are well within the range of observed rates of return for petroleum and other capital-intensive industries referred to in the statement of Mr. Huston.[51] In the opinion of Mr. Huston, they constitute a modest return considering the risks involved.[52]

ARCO Pipe Line is not contending in this proceeding for these methods, or any other new method of determining allowable rate of return; rather, it contends that the traditional ICC methodology should be applied unless properly modified in a lawful manner in a proceeding such as Ex Parte No. 308. *It wishes the Commission to understand, however, that the rate of return figures advanced by various protestants have absolutely no foundation in economic reality and must be wholly disregarded by the Commission.*

C. The Lenzner Preliminary Statement is Irrelevant to Any Issue Presently Before the Commission.

The voluminous Preliminary Statement of Terry F. Lenzner, which accompanies the State of Alaska's formal

51. Appendix D at 7.
52. Appendix D at 7.

pleading, is the only material submitted by any protestant which addresses specific factual issues. That statement is expressly *not* relied upon by the State of Alaska in its calculations of proposed tariff reductions and thus presents no question for resolution by the Commission in its proceeding today.[53] Its sole pupose would seem to be to portray Alyeska and the carriers in an unfavorable light by using a selective grab-bag of apparently damaging facts and admissions and thereby to drive the Commission to accept Alaska's lower tariff despite the demonstrable weaknesses in its legal and economic arguments. ARCO Pipe Line rejects the conclusions reached in the Lenzner Statement, as well as the technique of adducing as evidence a smattering of documents and testimony taken out of context. It fully intends to rebut the unfounded charges and correct the distorted impressions. However, as Alaska itself all but concedes, the appropriate setting for accomplishing this is the "ultimate investigation."[54]

Unlike a summary suspension proceeding, with its nonexistent discovery and abbreviated schedule, an investigation provides the procedural tools for eliciting relevant evidence and the time to consider that evidence with care. The story which will emerge from the investigative process is that the managers of the TAPS project faced complicated and novel problems. With the benefit of hindsight, it may appear that mistakes were sometimes made. However, if anyone believes that infallibility is the test of prudent management, he misconceives both the nature of business and the state of the law. Moreover, as the material presented in the Lenzner Statement makes clear, respondents were not indifferent, but highly sensitive to efficiency

53. Alaska Protest at 10-11.
54. Alaska Protest at 10.

and cost issues, and sought to unearth problems in these areas, and devise policies to correct them. Indeed, the documentary materials upon which Lenzner relies, selectively drawn as they were largely from the massive files of Alyeska, exist precisely because Alyeska and its owner companies *were* concerned with efficiency and economy. The management actions involved were administratively sound and are legally unassailable.

A full investigation will place the building of the pipeline in its proper context. Contrary to the impressions artfully created in the Lenzner piece, TAPS was not a routine public works project. Rather, it was a unique undertaking of enormous scale which presented a host of novel questions and required, in turn, novel, often "state of the art," solutions. The builders were not only faced with the task of constructing one of the longest, largest diameter pipelines ever conceived, but of doing so through remote, rugged terrain, under adverse climatic conditions at a time when a heightened environmental awareness demanded the imposition of stringent safeguards. They had to cope with a myriad of government agencies with often conflicting regulations. They had to design a system to withstand both earthquakes and tidal waves and utilize technology and materials never employed before. Significant public policy considerations mandated the completion of the project in the shortest possible time: the economic need to reduce our balance of payments deficit and the national security interest in decreasing dependence on imported crude oil and becoming more energy self-sufficient. Against this backdrop, the Trans Alaska Pipe Line was built, and operations were begun in accordance with the schedule.[55]

55. Much of Mr. Lenzner's presentation seems to be a complaint that TAPS owners and Alyeska were pushing to complete the project rapidly. The rapid and timely completion of TAPS, of course,

These factors—and their impact upon the TAPs project—must be part of any assessment on construction performance and cost. A balanced and complete investigation of the building of the pipeline will result in a vindication of Alyeska and the carriers and the approval of the capital expenditures upon which the tariffs are based.

D. The Calculations of ARCO Pipe Line With Respect To Depreciation and Removal Costs Are Proper.

The carriers based their calculations of book depreciation on a 25 year useful life for the pipeline. Three of the protestants, the Bureau, ASRC and the State of Alaska, challenge this assumption, with the Bureau arguing for a 27.5 year period and Alaska and ASRC contending for a period of 35 years.[56]

As indicated in Appendix A, ARCO Pipe Line's use of a 25 year life was based on studies by certain producers showing that production in the Sadlerochit Reservoir would decline by the year 2002 to a level such that continuing operation of the system would be uneconomical. This represents the best judgment of ARCO Pipe Line at this time, and is consistent with the FPC recommendation relied

conferred a considerable benefit upon Alaska, whose substantial tax revenues, derived from both oil production and pipeline operations (*see* pp. 31-32, *supra*), could not begin until TAPS went into operation. In addition, the national interest in early production has been and is apparent. Apart from the reduced reliance on foreign oil, which North Slope production will bring about, the North Slope production will also produce a favorable balance of payments impact in the United States of approximately six billion dollars annually. This is based on production at 1.2 million barrels per day and a representative value of foreign crude delivered in foreign tankers of approximately $13.70 per barrel. Rapid completion also avoided the substantial costs of mobilization and de-mobilization for an additional construction season, and eliminated the impact of further construction cost escalation as a result of inflationary factors.

56. Bureau Protest at 23, Alaska Protest at 51, ASRC Protest at 15.

on by the Bureau, which used a recovery period of 25 to 30 years.[57]

Any conclusion that the useful life should be substantially longer than 25 years must rest on the assumption that oil formations other than the Sadlerochit Reservoir will be developed. The State mentions the Lisburne and Kuparuk Oil Pools as possibilities, as well as Naval Petroleum Reserve Four and the Beaufort and Chukchi Sea areas.[58] Such development may occur, but whether it will is at present a highly speculative matter, depending on such imponderable factors as the results of further drilling, the cost of petroleum from other sources, and future Government regulations which may impact the exploration and production of petroleum. It is rational and prudent for those who are making large investments in transportation facilities to base their plans on reasonably certain sources, not speculative events.

In addition to challenging the depreciation basis, the Bureau and the State of Alaska would also have the Commission disallow part of the expense projected by ARCO Pipe Line in connection with the carriers' obligation to remove the pipeline facilities and restore the surface at the end of the pipeline's service life. The basis for ARCO Pipe Line's calculation of removal costs is explained in detail in Appendix A. The method adopted for dealing with the removal cost properly takes into account inflation over time and the tax treatment of collections relating to the removal obligation.

CONCLUSION

The only means by which both the protestants and the carriers can be treated lawfully and equally is to permit the tariffs here at issue to become effective as scheduled.

57. Bureau Protest at 22.
58. Alaska Protest at 46-47. *See also* ASRC Protest at 15.

Any other approach will be in contravention of the limitations on the Commission's powers to suspend and to order rates, and will subject the carriers to the possibility of unwarranted, but unrecoverable, losses. If the tariffs are permitted to go into effect, and are ultimately found to be unlawful, the protestants can be adequately protected through the mechanisms provided for in the Interstate Commerce Act and elsewhere.

ARCO Pipe Line does not object to an investigation into the lawfulness of the tariffs. It submits, however, that any attempt to engage in rate-making at this time, on the basis of the limited factual record and unsound economic presentations now before the Commission, would virtually guarantee an arbitrary, capricious and incorrect result.

For the foregoing reasons, ARCO Pipe Line Company urges that its tariff be permitted to go into effect as scheduled, subject to a full, but prompt, investigation.

Respectfully submitted

ROBERT E. JORDAN, III
JAMES H. PIPKIN, JR.
Steptoe & Johnson
1250 Connecticut Avenue
Washington, D.C. 20036
(202) 862-2000
Attorneys for ARCO
Pipe Line Company

Of Counsel:

JOHN T. UPDEGRAFF
ARCO Pipe Line Company
ARCO Building
Independence, Kansas 67301

Dated: June 22, 1977

[Certificate of Service Omitted]

[Caption Omitted]

APPENDICES TO RESPONSE OF ARCO PIPE LINE COMPANY TO PROTESTS AND PETITIONS FOR SUSPENSION AND INVESTIGATION OF ICC TARIFF NO. 1030 ISSUED MAY 31, 1977

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EXHIBIT
IN SUPPORT OF
ARCO PIPE LINE COMPANY
ICC TARIFF NO. 1030
FOR TRANSPORTATION OF PETROLEUM FROM
PRUDHOE BAY, ALASKA TO VALDEZ, ALASKA
IN INTERSTATE COMMERCE

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—Provision for Dismantling Cost	456a
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—Interest Costs	458a
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—State of Alaska Gross Receipts Taxes	458a
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APPLICATION OF HISTORICAL ICC METHODOLOGY TO ESTABLISH THE INITIAL TARIFF FOR THE TRANS ALASKA PIPELINE SYSTEM PREPARED BY ARCO PIPE LINE COMPANY

INTRODUCTION

This memorandum will document the various data considerations, assumptions and methodologies employed in establishing a tariff rate of $6.04 per barrel over ARCO Pipe Line Company's ("ARCO Pipe Line") undivided interest portion of the Trans Alaska Pipeline System ("TAPS"). The detailed calculations and methodology employed and described herein are believed to be wholly consistent with the historical methodology employed by the Interstate Commerce Commission (ICC) with respect to valuation and allowable rates of return for oil pipeline systems.

ORIGINAL COST DATA

Actual construction expenditures from 1969 through 1976 and estimated 1977 expenditures, were supplied to ARCO Pipe Line and the Commission by Alyeska Pipeline Service Company ("Alyeska"). These expenditures were segregated by year of expenditure by account for accounts 151 through 165, and were the basis for the determination of the original cost data. (See Schedule 8, page 4).

ICC methodology requires that engineering overhead and general and administrative (G&A) overhead be broken out separately from the various accounts. (Testimony of Jesse C. Oak, Senior Valuation Engineer, Bureau of Accounts, Interstate Commerce Commission, submitted in Ex Parte No. 308 on March 25, 1977 ("Oak Statement"), Appendix B thereto, page B-5). Based upon information supplied by

Alyeska, the engineering and G&A overhead amounts were taken out of accounts 153 through 165 and accumulated separately.

The amounts reported in account 162 (Delivery Facilities) include costs which require reclassification to other primary accounts for valuation purposes. An analysis of account 162 by year by type of expenditure was provided by Alyeska. After allocating certain construction overheads included therein among the other expenditures included in Account 162, these expenditure groups were added to the appropriate primary accounts to arrive at "As-Adjusted original cost for accounts 153-162. (See Schedule 8, page 5).

In order to arrive at the total original cost of construction for use in the valuation process, the G&A and engineering overheads previously segregated, along with interest costs capitalized during construction, were added to "As-Adjusted" original cost.

It should be noted that interest and related costs on funds borrowed specifically for this project were capitalized throughout the construction period in accordance with ICC accounting regulations. In order to determine the total interest capitalized to be included in the original cost, an analysis of actual debt cost relating to the project was prepared through March 31, 1977 and the estimated interest to be incurred during the period April 1, 1977, through August 31, 1977 was calculated. This was based on the debt outstanding at March 31, 1977, the debt expected to be incurred between March 31 and August 31, and debt expected to be repaid during the same period. In addition to interest, the other related capitalized costs of debt were commitment fees on short-term debt agreements, debt discount amortization, and amortization of long-term debt expenses for the

applicable period. This produced the total interest and financing costs capitalized on the project through August 31, 1977, the projected date for the first delivery of oil at Valdez.

To summarize, the original cost of construction used in the ICC Valuation process consists of (1) the "As-Adjusted" expenditures by primary ICC account; (2) engineering and G&A overheads; and (3) interest capitalized during the construction period. (See Schedule 8, page 2).

COST OF REPRODUCTION NEW

The annual indices published by the Commission for 1969 through 1975, and the preliminary 1976 indices released by the Commission were used as a base to estimate annual indices for 1977 through 1982. These annual indices by primary account were inflated for the periods 1977 through 1982 based on inflation rates as follows: 1977 through 1980 —8%; 1981—7.8% and 1982—7.6%.

The period indices were calculated for each year by averaging the annual indices by primary account for the preceding three years, the current year and the subsequent year. This is the method of calculation used by the ICC. (Oak Statement at 18).

These annual and period indices were then applied to original cost construction expenditures by primary account to calculate the cost of reproduction new (CRN) following the ICC methodology as described below. First, all expenditures were reduced to 1947 dollars through the use of the annual indices. This was accomplished by dividing each year's "As-Adjusted" original cost expenditures for each primary account by the appropriate annual index for that particular account for the year in which the expenditure was made. (This accomplishes the same results as the use of 1947 period guide prices referred to in Oak State-

ment at 17.) Cost of Reproduction New (CRN) for 1977 through 1980 was then calculated by multiplying the 1947 base costs for each primary ICC account by the appropriate period indices, determined as described above. The technique of applying annual indices to expenditures by year of expenditure to arrive at 1947 base costs is considered to be an appropriate application of ICC methodology for a project whose period of construction extends over a number of years.

Engineering and G&A overhead percents were then applied to the CRN totals of accounts 153-165. The overhead percents were determined based on the relationship of the actual overheads to original cost excluding overheads.

Interest capitalized during construction was applied to the total of the above at the 6% annual rate historically used in ICC methodology. The period used for capitalization of interest was two years, which is one-half the construction period plus three months. The 12% total rate was developed through use of the following ICC formula:

$$\frac{\frac{42+3}{2}}{12} \times 6\% = 12\%$$

CONDITION PERCENTS

Since Section 19a of the Interstate Commerce Act requires that the ICC determine the cost of reproduction new less depreciation, some measure of depreciation must be applied to the current period cost of reproduction new. The condition percent factor, as used by the Commission, is the ratio of the remaining probable life of the property at an attained age to its total probable life. The application of this factor to the cost of reproduction new is intended by the ICC to produce a reasonable estimate of the value of the property in its present condition.

Protest Reply of ARCO Pipe Line.

The ICC has published two tables of condition percents; one for pipe and fittings and the other for building and machinery (See Oak Statement, Appendix D thereto, page 3). The condition percents relating to pipe and fittings were applied to the expenditures in accounts 153 through 155 and the condition percents relating to the building and machinery category were applied to accounts 156 through 165.

A condition percent of 100% was used for 1977 CRN, since the pipeline began operation as a new facility in 1977. The 1977 CRN times the appropriate condition percent for one year old property was used in the calculation of the valuation used for 1978. A similar procedure, taking into account additional years of use, was employed to calculate CRN for 1979, 1980 and 1981. (Note that CRN in Columns 2 and 5 on page 7 of Schedule 8 are the same amounts.)

Additions to the project after the initial start-up date of September 1, 1977, have been accounted for separately and the appropriate condition percents applied to these additions. The condition percent for the additions required for the 1980 expansion was set at 100% in 1981, the first year the expansion was included in the valuation.

For purposes of applying condition percents on additions to the project, all additions subsequent to the date of the initial in-service date are expected to be in the building and machinery category and the appropriate condition percents for this category have been applied. (See Schedule 8, page 7.)

GOING CONCERN

An amount equivalent to 6% of the weighted average cost is added to valuation for the intangible value of a going concern. This is consistent with historical ICC procedure. (Oak Statement at 25).

Protest Reply of ARCO Pipe Line.

LAND AND RIGHTS-OF-WAY

In lieu of making actual appraisals, valuations currently include land values estimated at 50% of original cost. Therefore 50% of the actual cost of land was used to estimate present value. This is consistent with current ICC procedure which values land at one-half of original cost. (Oak Statement at 21). Because of the immaterial cost ($.2 million), 100% of the actual cost of rights-of-way was used in estimating valuation each year.

WORKING CAPITAL

Working capital was estimated by making allowance for the funds necessary to meet current operating expenses which must be paid in advance of receipts of operating revenues from carrier operations. A 15-day lag between the payment of expenses and the receipt of revenues was utilized. The value of material and supplies on hand was estimated to be zero.

EXPANSION

The additional pumping stations to be added in 1980 entered into the Valuation used to calculate the tariff in the year following their in-service date. The same methodology was used to determine reproduction cost new for expansion additions as was used for construction costs in the original system.

The valuation as determined was then used as the earnings base in the calculation of earnings.

Protest Reply of ARCO Pipe Line.

VALUATION COMPUTATION

As set forth in the Oak Statement at 27, the computation of a single sum valuation has been reduced to the formula below:

$$V = \left[\left(\frac{CRN}{CRN+OC}\right) \times (CRN) + \left(\frac{OC}{CRN+OC}\right) \times (OC) \times \left(\frac{CRNLD}{CRN}\right)\right] \times (1.06) + (L+ROW+WC)$$

V	=	Single-sum value (valuation)
CRN	=	Cost of reproduction new
CRNLD	=	Cost of reproduction new, less depreciation
OC	=	Original cost
L	=	Present value of lands
ROW	=	Present value of rights-of-way
WC	=	Working capital

In practice the CRN less depreciation is separately determined for (1) Pipe and Fittings, (2) Building and Machinery, and (3) additions in different years, using the appropriate percent from the Condition Percent Tables. A weighted average condition percent is computed using the total of CRN and CRNLD for all properties. (See Schedule 8, page 7.)

TARIFF COMPUTATION

The $6.04 per barrel tariff is an average based on operations for years 1977 through 1981. (See Schedule 1). Utilizing this period, the following earnings and operating expenses are anticipated for the period from September 1, 1977 to December 31, 1981:

Protest Reply of ARCO Pipe Line.

(Unless otherwise indicated, dollar figures are in millions.)

Operation and maintenance		$ 266.7
Depreciation		345.3
Interest		561.2
Alaska Taxes—		
Gross Receipts	$ 6.6	
Ad valorem	152.5	
Income	104.4	
Total Alaska Taxes		263.5
Dismantling costs		52.9
Federal income taxes		552.6
Return on investment		598.8
Total		$2,641.0
Estimated throughput (Millions of barrels)		437.0
Tariff rate (Dollars per barrel)	$ 6.04	

THROUGHPUT ASSUMPTIONS

Throughput estimates used as a basis for determining the tariff were .6 million barrels per day (MBD) from September 1, 1977 to October 31, 1977; 1.2 MBD from November 1, 1977 to June 30, 1980; and 1.6 MBD from July 1, 1980 to December 31, 1981.

ARCO Pipe Line's portion of the throughput was determined by applying its 21% ownership factor to the throughput assumptions listed above.

OPERATING AND MAINTENANCE EXPENSE

Estimated operating and maintenance expenses for 1977 and 1978 were supplied by Alyeska. The expenses supplied by Alyeska included all costs with the exception of fuel. Alyeska estimated 30% of the fuel requirements for pump

station #12 and the Valdez terminal, the only fuel which Alyeska itself would purchase. The balance of the fuel attributable to its throughput will be purchased by ARCO Pipe Line. Therefore, it was necessary to estimate costs for the remaining fuel requirements at pump station #12 and the other pump stations based on the consumption of natural gas and turbine fuel at the throughput levels shown above. The estimated price per barrel of turbine fuel and MCF of natural gas was based on estimated 1977 price levels escalated by the same annual inflation rates discussed under "Cost of Reproduction New" above. Operating and maintenance expenses subsequent to 1978, exclusive of fuel, were estimated using the total 1978 estimated operating expenses, excluding nonrecurring maintenance of haul roads to be turned over to the State, increased by the same annual inflation rates.

PROVISION FOR DISMANTLING COST

Dismantling and restoration costs were estimated by Alyeska to total $1.049 billion (at 1977 price levels). ARCO Pipe Line's 21% portion amounts to $220.3 million. The cost estimated at year 2002 price levels was determined using the same annual inflation rates mentioned under "Cost of Reproduction New" above through 1982 and declining rates thereafter through 1990 (reduced .2% annually). A 6% rate was used from 1991 through 2002. Through this procedure, it was estimated that ARCO Pipe Line would need approximately $1.096 billion in year 2002 (the end of the useful life of TAPS) to cover its 21% portion of the dismantling costs. (See Schedule 3, page 2). The inflated dismantling cost ($1.096 billion) was then used to calculate the necessary annual cost to be charged customers which together with interest earnings at a rate of 7.5% compounded monthly (an effective annual rate of approximately 7.76%) would accumulate to ARCO Pipe Line's projected year 2002 requirement of $1.096 billion.

In addition, it was assumed that the provision for dismantling costs would not be deductible for income tax purposes. Consequently, ARCO Pipe Line would be required to pay income taxes on the amounts collected with respect to the provisions. This payment of income tax results in a reduced rate of retirement of debt, which in turn causes interest expense to be greater. The increased interest due to the required use of funds to pay added taxes is another cost of providing the reserve for dismantling. Over the 25-year life of the system, such amounts total $315.4 million. The total cost of $1.411 billion ($1.096 billion plus $.315 billion equals $1.411 billion) was allocated over the 25-year life of the facilities so that approximately equal charges (in terms of 1977 dollars) will be included each year. The same annual inflation rates mentioned above were used to adjust for the effects of inflation in making this allocation. The resulting charges (details of which are on Schedule 3, page 1) are as follows (in millions):

Year	Annual Amount	Total
1977	$ 4.1	$ 4.1
1978 through 1981	12.2	48.8
1982 through 1986	14.7	73.5
1987 through 1991	16.4	82.0
1992 through 1996	17.8	89.0
1997 through 2001	18.4	92.0
2002	15.0	15.0
		$404.4
Anticipated interest income at 7.76%		691.7
Total Fund		$1,096.1

Protest Reply of ARCO Pipe Line.

DEPRECIATION PROVISIONS

A useful life of 25 years was used for book depreciation purposes based on studies by certain producers showing production declining in 2002 to the level that continuing operation of the system will be uneconomical because declining throughput will drive the tariff to levels which would price North Slope Oil out of the market.

INTEREST COSTS

Interest costs by year were calculated based on the estimated outstanding debt as of September 1, 1977, the mandatory retirements scheduled for long-term debt and additional retirements of (or purchases of) commercial paper permitted by available cash flows from depreciation and net deferred taxes. It was assumed that any cash in excess of current requirements would be invested in commercial paper with a 6-½% interest rate. Estimated income on such short term investments was used as a reduction of interest expense for tariff calculations. (See Schedule 6).

STATE OF ALASKA AD VALOREM TAXES

Ad valorem taxes were based on a 2% rate applied to original cost (other than interest capitalized during construction) less applicable book depreciation accumulated as of the beginning of each year, adjusted for inflation. (See Schedule 4).

STATE OF ALASKA GROSS RECEIPTS TAXES

Gross receipts taxes were based on the current effective rate of ¼ of 1% of total revenues.

Protest Reply of ARCO Pipe Line.

FEDERAL AND STATE OF ALASKA INCOME TAXES

State income taxes were calculated based on a state income tax rate of 9.4%, adjusted to 8.3% to reflect the anticipated multiple state taxable income allocation provisions to which the State of Alaska subscribes. Federal income taxes were calculated at 48% of income before income taxes after deduction of the state income tax provision at 8.3%. (See Schedule 7).

Income taxes were calculated at appropriate federal and state income tax rates assuming full inter-period income tax allocation (sometimes referred to as normalization). Consequently, deferred federal and state income taxes were provided for timing differences arising from accelerated depreciation, current deduction of interest and taxes capitalized on the books and a 60-month amortization for tax purposes of research and development costs depreciated at 4% per year on the books. This is consistent with accounting requirements of the Commission.

No cash flow benefits of accelerated tax deductions are realized by ARCO Pipe Line until such amounts would be realized on the basis of a separate income tax return.

RETURN ON VALUATION

Return on valuation was calculated at 7% of the calculated valuation over the period to the end of the fourth full year of operations. (See Schedule 1).

SCHEDULE 2
Page 1 of 3

ARCO PIPE LINE COMPANY

TRANS ALASKA PIPELINE SYSTEM

INITIAL TARIFF - INCOME SUMMARY

1977-1981

Line No.	Description	Schedule No.	(Col. 1) 1977	(Col. 2) 1978	(Col. 3) 1979	(Col. 4) 1980	(Col. 5) 1981	(Col. 6) 1977-1981 Total
					(millions)			
1	Estimated through-put (millions of barrels)		23.038	91.980	91.980	107.310	122.640	436.968
2	Tariff rate (dollars per barrel)		$6.044	$6.044	$6.044	$6.044	$6.044	$6.044
3	Revenues		$139.4	$555.9	$555.9	$648.6	$741.2	$2,641.0
	Operating expenses:							
4	Operations and maintenance	2	22.3	53.6	56.1	63.4	71.3	266.7
5	Provision for dismantling cost	3	4.1	13.2	13.2	13.2	13.2	52.9
6	Ad Valorem taxes	4	8.6	34.3	34.2	35.4	40.0	152.5
7	Gross receipts taxes (1/4 of 1% of Line 3)		.3	1.4	1.4	1.6	1.9	6.6
8	Provision for depreciation	5	25.7	77.2	77.2	80.8	84.4	345.3
9	Interest	6	48.1	139.0	128.1	123.2	122.8	561.2
10	Total operating expenses		109.1	317.7	309.2	316.6	332.6	1,385.2
11	Income before income taxes		30.3	238.2	246.7	332.0	408.6	1,255.8
12	Provision for income taxes	7	15.8	124.6	129.0	173.7	213.9	657.0
13	Net income		$ 14.5	$113.6	$117.7	$158.3	$194.7	$ 598.8
14	% of valuation	8	$ 48.7	$137.1	$133.3	$133.6	$144.1	$ 598.8

SCHEDULE 1
Page 1 of 1

SCHEDULE 2
Page 1 of 3

ARCO PIPE LINE COMPANY

TRANS ALASKA PIPELINE SYSTEM

SUMMARY OF OPERATING EXPENSES

1977-1981

Line No.	Description	(Col. 1) 1977	(Col. 2) 1978	(Col. 3) 1979	(Col. 4) 1980	(Col. 5) 1981
				(millions)		
1	Operating and maintenance expense	$ 99.4	$223.8	$233.5	$252.2	$271.8
2	Fuel costs - Natural gas (p. 2, Line 17)	4.3	17.4	18.8	27.5	37.4
3	Turbine fuel (p. 3, Line 12)	2.6	13.8	14.9	22.1	30.3
4	Total operating and maintenance expenses	$106.3	$255.0	$267.2	$301.8	$339.5
5	ARCO portion (21%) (To Schedule 1, Line 4)	$ 22.3	$ 53.6	$ 56.1	$ 63.4	$ 71.3

SCHEDULE 2
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SCHEDULE 2
Page 2 of 3

ARCO PIPE LINE COMPANY

TRANS ALASKA PIPELINE SYSTEM

CALCULATION OF NATURAL GAS COST

1977 - 1981

Line No.	Description	(Col. 1) 1977	(Col. 2) 1978	(Col. 3) 1979	(Col. 4) 1980	(Col. 5) 1981
1	Through-put assumptions (millions of barrels per day)	.6 Sept.-Oct. 1.2 Nov.-Dec.	1.2	1.2	1.4	1.6
	Natural Gas Consumption -					
2	MMCF at .6 MBPD	12.7	-	-	-	-
3	Days Pumped	61	-	-	-	-
4		774.7	-	-	-	-
5	MMCF at 1.2 - MBPD	21.0	21.0	21.0	21.0	-
6	Days Pumped	61	365	365	182.5	-
7		1,281.0	7,665.0	7,665.0	3,832.50	-
8	MMCF at 1.6 - MBPD	-	-	-	35.9	35.9
9	Days Pumped	-	-	-	182.5	365
10		-	-	-	6,551.75	13,103.5
11	Total Natural Gas Consumption in MMCF (Lines 4 + 7 + 10)	2,055.7	7,665.0	7,665.0	10,384.25	13,103.5
	Price per MMCF -					
12	1977 MCF Price	$2.10				
13		x 1,000				
14	Prior Year Price		$2,100	$2,268	$2,449.4	$2,645.4
15	Inflation Rate		x 1.08	x 1.08	x 1.08	x 1.078
16	Price per MMCF	$2,100	$2,268	$2,449.4	$2,645.4	$2,851.7
17	Total cost (Line 11 x Line 16) (To Page 1, Line 2)	$4.3 M	$17.4 M	$18.8 M	$27.5 M	$37.4 M

SCHEDULE 2
Page 3 of 3

ARCO PIPE LINE COMPANY

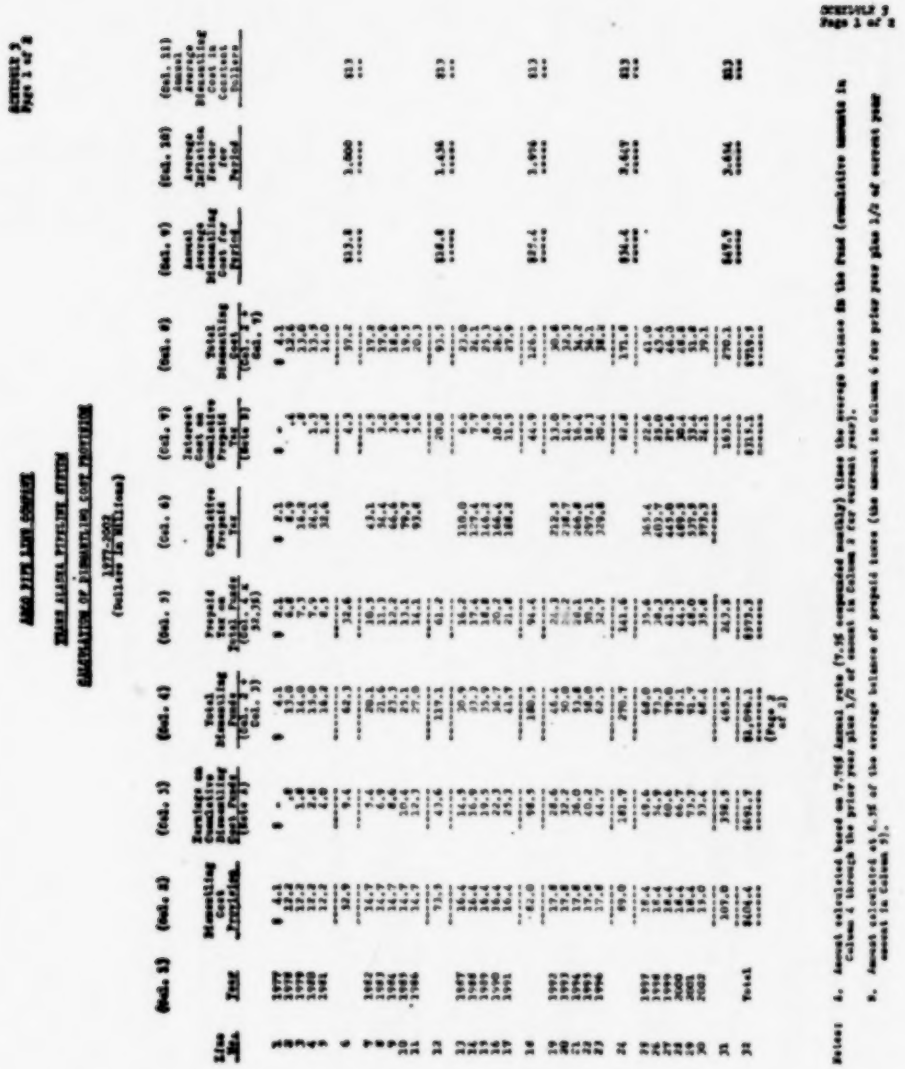
TRANS ALASKA PIPELINE SYSTEM

CALCULATION OF TURBINE FUEL COST

1977 - 1981

Line No.	Description	(Col. 1) 1977	(Col. 2) 1978	(Col. 3) 1979	(Col. 4) 1980	(Col. 5) 1981
1	Through-put Assumptions (millions of barrels per day)	.6 Sept.-Oct. 1.2 Nov.-Dec.	1.2	1.2	1.4	1.6
	Turbine fuel cost:					
2	Barrels per period consumed	355,053	1,734,619	1,734,619	2,388,143	3,041,667
	Price per barrel:					
3	Price before current period inflation	$6.97	$6.97	$7.53	$8.13	$8.78
4	Inflation factor	1.00%	1.08%	1.08%	1.08%	1.078%
5	Price per barrel inflation adjusted	$6.97	$7.53	$8.13	$8.78	$9.46
6						
6	Cost (Line 2 X Line 5)	$2.5 M	$13.1 M	$14.1 M	$21.0 M	$28.8 M
	Degradation costs:					
7	Gross barrels per period (Line 2 ÷ .22)	1,613,877	7,884,632	7,884,632	10,855,195	13,825,759
8	Barrels per period consumed (Line 2)	(355,053)	(1,734,619)	(1,734,619)	(2,388,143)	3,041,667
9	Degraded barrels per period	1,258,824	6,150,013	6,150,013	8,467,052	10,784,092
10	Degraded cost per barrel, inflation adjusted	10.5¢	11.3¢	12.2¢	13.2¢	14.2¢
11	Degradation cost Line	$ .1 M	$ .7 M	$ .8 M	$ 1.1 M	$ 1.5 M
12	Total turbine fuel cost (Line 6 + Line 11)	$ 2.6 M	$13.8 M	$14.9 M	$22.1 M	$30.3 M

Protest Reply of ARCO Pipe Line.



Protest Reply of ARCO Pipe Line.

SCHEDULE 3
Page 2 of 2

ARCO PIPE LINE COMPANY
TRANS ALASKA PIPELINE SYSTEM
CALCULATION OF DISMANTLING COST PROVISION
1977-2002

Line No.	Description	(Col. 1) Annual Inflation Rate	(Col. 2) Amount (millions)
1	Estimated cost of dismantling and restoration as of August 31, 1977		$1,049.0
	Amount estimated at each year-end, adjusted for inflation—		
2	1977	8.0%	1,077.0
3	1978	8.0%	1,163.2
4	1979	8.0%	1,256.3
5	1980	8.0%	1,356.8
6	1981	7.8%	1,462.6
7	1982	7.6%	1,573.8
8	1983	7.4%	1,690.3
9	1984	7.2%	1,812.0
10	1985	7.0%	1,938.8
11	1986	6.8%	2,070.6
12	1987	6.6%	2,207.3
13	1988	6.4%	2,348.6
14	1989	6.2%	2,494.2
15	1990	6.0%	2,643.9
16	1991	6.0%	2,802.5
17	1992	6.0%	2,970.7
18	1993	6.0%	3,148.9
19	1994	6.0%	3,337.8
20	1995	6.0%	3,538.1
21	1996	6.0%	3,750.4
22	1997	6.0%	3,975.4
23	1998	6.0%	4,213.9
24	1999	6.0%	4,466.7
25	2000	6.0%	4,734.7
26	2001	6.0%	5,018.8
27	2002	6.0%	5,219.6
28	ARCO's portion (Line 27 x 21%)		$1,096.1

(To p. 1, Line 32, Col. 4)

SCHEDULE 4
Page 1 of 1

ARCO PIPE LINE COMPANY

TRANS ALASKA PIPELINE SYSTEM

CALCULATION OF AD VALOREM TAX

Line No.	Description	Source	(Col. 1) 1977	(Col. 2) 1978	(Col. 3) 1979	(Col. 4) 1980	(Col. 5) 1981
					(millions)		
1	Estimated furnished by Alyeska		$8.6	$34.3			
	Ad Valorem Tax Base:						
	Depreciable plant in service at August 31, 1977, excluding interest capitalized						
2		Schedule 5, Line 2			$1,671.4	$1,671.4	$1,671.4
	Less- Depreciation for -						
3	1977	(Line 2 X 4% X 4/12)			(22.3)	(22.3)	(22.3)
4	1978	(Line 2 X 4%)			(66.9)	(66.9)	(66.9)
5	1979	(Line 2 X 4%)			-	(66.9)	(66.9)
6	1980	(Line 2 X 4%)			-	-	(66.9)
7	Tax base of initial plant in service				1,582.2	1,515.3	1,448.4
	Additions to depreciable plant in service as of June 30, 1980, excluding interest capitalized						
8		Schedule 8, p. 6, Line 6			-	-	146.6
9	Less- Depreciation for 1980	(Line 8 X 4.5% X 6/12)			-	-	(3.3)
10	Tax base of 1980 additions				-	-	143.3
11	Total tax base	(Line 7 & 10)			$1,582.2	$1,515.3	$1,591.7
12	Tax on original cost basis	(Line 11 X 2%)			$ 31.7	$ 30.3	$ 31.8
13	Cumulative inflation rate factor as of beginning of year				1.06%	1.17%	1.26%
		(1.06 X 1.06)					
		(1.17 X 1.06)					
14	Estimated tax for year.	(To Schedule 1, Line 6)	$8.6	$34.3	$ 34.2	$ 35.4	$ 40.0

SCHEDULE 5
Page 1 of 1

ARCO PIPE LINE COMPANY

TRANS ALASKA PIPELINE SYSTEM

SCHEDULE OF DEPRECIATION EXPENSE

1977-1981

Line No.	Description	Source	(Col. 1) 1977	(Col. 2) 1978	(Col. 3) 1979 (millions)	(Col. 4) 1980	(Col. 5) 1981
	DEPRECIABLE PLANT:						
1	Initial plant - Construction expenditures at August 31, 1977 (excluding land of $15)	Schedule 8, p.2, Col. 10 Line 19	$7,959	$7,959	$7,959	$7,959	$7,959
2	ARCO portion	Line 1 x 21%	$1,671.4	$1,671.4	$1,671.4	$1,671.4	$1,671.4
3	Add - Interest capitalized	Schedule 8, p.2	257.7	257.7	257.7	257.7	257.7
4	Depreciable plant in service, August 31, 1977		$1,929.1	$1,929.1	$1,929.1	$1,929.1	$1,929.1
5	Expansion of depreciable plant in service in 1980	Schedule 8, p.2	$ -	$ -	$ -	$ 159.3	$ 159.3
	DEPRECIATION EXPENSE:						
6	Depreciable plant in service, August 31, 1977	Line 4 x 4% x no. of months in period ÷ 12	$ 25.7	$ 77.2	$ 77.2	$ 77.2	$ 77.2
7	Expansion of depreciable plant in service in 1980	Line 5 x 4.5% x no. of months in period ÷ 12	-	-	-	3.6	7.2
8	Total depreciation expense	Schedule 1, Line 8	$ 25.7	$ 77.2	$ 77.2	$ 80.8	$ 84.4

SCHEDULE 6
Page 1 of 2

ARCO PIPE LINE COMPANY

TRANS ALASKA PIPELINE SYSTEM

DETAIL OF INTEREST EXPENSE

1977-1981

Line No.	Description	Source	(Col. 1) 1977	(Col. 2) 1978	(Col. 3) 1979 (millions)	(Col. 4) 1980	(Col. 5) 1981
1	Long-term debt	P. 2, Line 13	$46.4	$139.3	$139.2	$137.7	$134.2
2	Amortization of debt discount and expense ($21.1 million amortized over life of debt)	P. 2, Line 19	.7	2.1	2.1	2.1	2.1
3	Commercial paper	P. 2, Line 24	1.0	(2.4)	(13.2)	(16.4)	(13.5)
4	Total	Schedule 1, Line 9	$48.1	$139.0	$128.1	$123.2	$122.8

ARCO PIPE LINE COMPANY

TRANS ALASKA PIPELINE SYSTEM

DETAIL OF INTEREST EXPENSE

1977-1981

Line No.	Description	(Col.1) Interest Rate	(Col.2) 1977-1981 Retirement Terms	(Col.3) Principal Amount Outstanding At August 31, 1977 (millions)	(Col.4) 1977	(Col.5) 1978	(Col. 6) 1979	(Col. 7) 1980	(Col. 8) 1981
					Interest Expense For				
	Long-term debt:								
1	Chase Manhattan	7.25%	Due 2/5/80	$ 25.0	$ .6	$ 1.6	$ 1.6	$ .2	$ -
2	Metropolitan Life	7.75%	$2 million per year beginning 6/7/79)	40.0	1.0	3.1	3.0	2.9	2.7
	ARCO Pipe Line Series Bonds -								
3	Series 1	6.70%	Due 11/1/81	200.0	5.8	17.4	17.4	17.4	14.5
4	Series 2	8.00%		250.0	6.7	20.0	20.0	20.0	20.0
5	Series 3	8 3/8%		250.0	7.0	20.9	20.9	20.9	20.9
6	Series 4	8.00%		200.0	5.3	16.0	16.0	16.0	16.0
7	Series 5	7.50%		150.0	3.7	11.3	11.3	11.3	11.3
8	Series 6	7.75%		150.0	3.9	11.6	11.6	11.6	11.6
9	Valdez Industrial Revenue Bonds	5.95%		265.0	5.2	15.7	15.7	15.7	15.7
10	Private placement	8 3/8%		125.0	3.5	10.5	10.5	10.5	10.5
11	Master Note Bank Loans	6.3%		169.0	3.7	11.0	11.0	11.0	11.0
12	Total long-term debt			$1,624.0					
13	Interest on long-term debt (to p. 1, Line 1)				$ 46.4	$139.3	$ 139.2	$ 137.5	$ 134.2
	Commercial paper:								
14	Balance at beginning of period				$ 63.5	$ 28.0	$ (74.1)	$(126.1)	$(212.2)
15	Add - 1980 expansion expenditures				-	49.4	74.6	35.2	-
16	Long-term debt retirement				-	-	2.0	27.0	202.0
17	Less - depreciation funds (Schedule 5, p.1, Line 8)				(25.7)	(77.2)	(77.2)	(80.8)	(84.4)
18	Deferred tax funds				(9.1)	(72.2)	(51.3)	(63.4)	(105.5)
19	Amortization of debt expense (to p.1, Line 2)				(.7)	(2.1)	(2.1)	(2.1)	(2.1)
20	Balance at end of period				$ 28.0	$(74.1)	$(128.1)	$(212.2)	$(202.2)
21	Average balance for period (Line 14 + 20 ÷ 2)				$ 45.7	$(23.1)	$(101.1)	$(170.2)	$(207.2)
22	Interest expense (Line 21 x 6.5%)				$ 1.0	$ (1.5)	$ (6.6)	$ (11.2)	$ (13.5)
23	Interest capitalized on 1980 expansion (to Schedule 7, Line 7)				-	(.9)	(6.6)	(5.2)	-
24	Interest expense on commercial paper (to p.1, Line 3)				$ 1.0	$ (2.4)	$ (13.2)	$ (16.4)	$ (13.5)

SCHEDULE 6
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SCHEDULE 7
Page 1 of 1

ARCO PIPE LINE COMPANY

TRANS ALASKA PIPELINE SYSTEM

CALCULATION OF INCOME TAX PROVISIONS

1977-1981

Line No.	Description	Source	(Col. 1) 1977	(Col. 2) 1978	(Col. 3) 1979 (Millions)	(Col. 4) 1980	(Col. 5) 1981
	Currently payable:						
1	Income before income taxes	Schedule 1, Line 11	$ 30.3	$ 236.2	$246.7	$332.8	$450.6
	Add-						
2	Provision for depreciation	Schedule 1, Line 8	23.7	77.2	77.2	80.8	84.4
3	Provision for dismantling cost	Schedule 1, Line 9	4.1	12.2	12.2	12.2	12.2
4	Earnings on dismantling fund	Schedule 3, p. 1, Col. 3	-	.8	1.8	2.8	4.0
			60.1	326.4	337.9	427.8	509.2
	Less-						
5	Tax depreciation		91.0	171.5	196.4	143.4	151.7
6	Amortization of research and development costs capitalized ($36.8 million) over 60 months		2.5	7.4	7.4	7.4	7.4
7	Interest during construction capitalized		-	.9	6.6	9.2	-
8	Taxable income (loss)		(33.4)	148.4	107.5	291.8	350.1
9	Less- Net operating loss carry-forward		(205.4)	(238.8)	(90.2)	-	-
10	Taxable income (net operating loss carry-forward)		$(238.8)	$ (90.2)	$ 17.3	$291.8	$350.1
11	State tax payable	Line 10 x 6.5%	$ -	$ -	$ 6.4	$ 20.9	$ 29.1
12	Federal tax payable	Line 10-Line 11 x 48%	-	-	34.0	110.9	154.2
	Deferred:						
13	State -	Line 1 x 6.5%	2.0	15.8	-	-	-
14		Lines 1-10 x 6.5%	-	-	14.1	6.7	6.9
15	Federal -	Lines 1-13 x 48%	13.3	104.8	-	-	-
16		Lines 1-10-14 x 48%	-	-	74.3	35.2	29.7
17	Total income tax expense	Line 1 x 52.32%, To Schedule 1, Line 12	$ 15.8	$ 124.4	$129.0	$171.7	$213.9

SCHEDULE 7
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SCHEDULE 8
Page 1 of 10

ARCO PIPE LINE COMPANY

TRANS ALASKA PIPELINE SYSTEM

SCHEDULE OF ICC VALUATION

1977-1981

Line No.	Description	Source	(Col. 1) 1977	(Col. 2) 1978	(Col. 3) 1979 (Millions)	(Col. 4) 1980	(Col. 5) 1981
1	Original cost (excludes land and rights-of-way)	P. 2, Line 19, Cols. 11 and 13	$1,929.2	$1,929.2	$1,929.2	$1,929.2	$2,088.5
2	Cost of reproduction new (Note)	P. 8, Line 25	1,998.1	1,998.1	2,144.2	2,331.5	2,687.2
3	Total	Line 1 + Line 2	$3,927.3	$3,927.3	$4,073.4	$4,260.7	$4,775.7
4	Weighted original cost	(Line 1 / Line 3) x Line 1	$ 947.7	$ 947.7	$ 909.2	$ 873.5	$ 913.3
5	Weighted cost of reproduction new	(Line 2 / Line 3) x Line 2	1,016.6	1,016.6	1,144.2	1,275.8	1,512.0
6	Total weighted average	Line 4 + Line 5	1,964.3	1,964.3	2,053.4	2,149.3	2,425.3
7	Weighted condition percent	P. 7, Line 9	100%	93.732%	88.502%	83.502%	79.842%
8	Weighted average, less depreciation	Line 6 x Line 7	1,964.3	1,841.6	1,817.3	1,794.7	1,936.4
9	Going concern	Line 8 x 6%	117.9	110.5	109.0	107.7	116.2
10	Land	P. 2, Line 20, Col. 11 x 30%	1.6	1.6	1.6	1.6	1.6
11	Rights-of-way		.2	.2	.2	.2	.2
12	Working capital		4.0	4.0	4.0	4.0	4.0
13	Valuation	Lines 8 + 9 + 10 + 11 + 12	$2,088.0	$1,957.9	$1,932.1	$1,908.2	$2,058.4
14	7% of valuation (4 months in 1977)	To Schedule 1, Line 14	$ 48.7	$ 137.1	$ 135.3	$ 133.6	$ 144.1

Note: Original cost and CRC for 1977 were used to estimate Valuation for 1977. In all other years the prior year amounts were used.

ARCO PIPE LINE COMPANY

TRANS ALASKA PIPELINE SYSTEM

SUMMARY OF ORIGINAL COST

1977-1981

Line No.	Account No.	Description	(Col. 1) 1969	(Col. 2) 1970	(Col. 3) 1971	(Col. 4) 1972	(Col. 5) 1973	(Col. 6) 1974	(Col. 7) 1975	(Col. 8) 1976	(Col. 9) 1977	(Col. 10) Total	(Col. 11) ARCO's 21%	(Col. 12) 1980 Expansion Expenditures	(Col. 13) Total ARCO Original Cost at 12-31-80
			Initial Construction Expenditures												
			(millions)												
1	153	Line Pipe	$14.0	$82.0	$55.0	$ -	$ -	$ -	$ 17.0	$ 14.0	$ -	$ 159.0			
2	154	Line Pipe Fittings	-	-	3.0	-	-	4.0	15.0	40.0	-	62.0			
3	155	Pipeline Construction	12.0	70.0	48.0	10.0	11.0	663.7	2,110.4	1,717.4	376.5	5,253.0			
4		Total Pipe and Fittings										$5,470.0	$1,148.9	$ -	$1,148.9
5	156	Buildings	2.0	3.0	1.0	-	2.0	47.7	102.4	150.4	42.6	$ 352.1		-	
6	157	Boilers	-	-	-	-	-	1.0	7.4	8.4	3.1	20.3		-	
7	158	Pumping Equipment	-	-	-	-	-	6.0	28.0	32.0	2.0	70.0		$136.3	
8	160	Other Station Equipment	-	-	7.0	5.0	1.0	88.2	149.7	273.4	317.5	777.8		-	
9	161	Oil Tanks	-	-	-	1.0	1.0	23.1	123.3	173.9	92.0	414.3		-	
10	162	Delivery Facilities	-	-	-	1.0	1.0	8.3	66.4	114.9	60.7	252.3		-	
11	163	Communication Systems	-	-	-	-	-	-	-	-	3.0	3.0		-	
12	164	Office Furn. and Fixtures	-	-	-	-	-	-	-	-	1.0	1.0		-	
13	169	Vehicles & Other Work Equip.	-	-	-	-	-	-	-	-	30.0	30.0		-	
14		Total Buildings & Machinery										$1,961.2	$ 407.7	$136.3	$ 544.0
		Overheads Capitalized													
15		Engineering										249.0	52.3		
16		General and Administrative										298.0	62.6		
17		Interest During Construction										-	237.7		
18												$ 547.0	$ 352.6	$ 22.8	$ 352.4
19		Total Original Cost, excluding Land and rights-of-way										7,959.0	1,909.2	159.3	2,068.5
20	151	Land										13.0	2.1	-	2.1
21	152	Rights-of-way										1.0	.2	-	.2
22		Total Original Cost										$7,973.0	$1,932.5	$159.3	$2,091.8

ARCO PIPE LINE COMPANY

TRANS ALASKA PIPELINE SYSTEM

ANALYSIS OF "AS-ADJUSTED" CONSTRUCTION EXPENDITURES

Line No.	Account No.	Description	(Col.1) As Reported by Alyeska	(Col.2) 1969 Account 162 Reclassification	(Col.3) As Adjusted	(Col.4) As Reported by Alyeska	(Col.5) 1970 Account 162 Reclassification	(Col.6) As Adjusted	(Col.7) As Reported by Alyeska	(Col.8) 1971 Account 162 Reclassification	(Col.9) As Adjusted	(Col.10) As Reported by Alyeska	(Col.11) 1972 Account 162 Reclassification	(Col.12) As Adjusted
			(millions)											
1	151	Land	$-	$	$ -	$-	$	$ -	$-	$	$ -	$-	$ 2	$ 2.0
2	152	Rights-of-way	-		-	-		-	-		-	-		-
3	153	Line Pipe	14		14.0	68		82.0	56		82.0	-		-
4	154	Line Pipe Fittings	-		-	-		-	3		3.0	-		-
5	155	Pipeline Construction	12		12.0	70		70.0	48		48.0	19		19.0
6	156	Buildings	1	0	3.0	1	0	2.0	1		1.0	-		-
7	157	Boilers	-		-	-		-	-		-	-		-
8	158	Pumping Equipment	-		-	-		-	-		-	-		-
9	160	Other Station Equipment	-		-	-		-	6	1	7.0	4	1	5.0
10	161	Oil Tanks	-		-	-		-	1		-	1		1.0
11	162	Delivery Facilities	2	(2)	-	2	(2)	-	1	(1)	-	3	(4)	1.0
12	163	Communication Systems	-		-	-		-	-		-	-		-
13	164	Office Furniture & Fixtures	-		-	-		-	-		-	-		-
14	169	Vehicles & Other Work Equip.	-		-	-		-	-		-	-		-

NOTE: The amounts as reported by Alyeska are taken from page 4 of this Schedule and the amounts from Account 162 reclassifications are taken from page 5.

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Page 3a of 10

ARCO PIPE LINE COMPANY

TRANS ALASKA PIPELINE SYSTEM

ANALYSIS OF "AS-ADJUSTED" CONSTRUCTION EXPENDITURES

Line No.	Account No.	Description	(Col.13)	(Col.14) 1973	(Col.15)	(Col.16)	(Col.17) 1974	(Col.18)	(Col.19)	(Col.20) 1975	(Col.21)	(Col.22)	(Col.23) 1976	(Col.24)
			As Reported by Alyeska	Account 162 Reclassi-fication	As Adjusted	As Reported by Alyeska	Account 162 Reclassi-fication	As Adjusted	As Reported of Alyeska	Account 162 Reclassi-fication	As Adjusted	As Reported by Alyeska	Account 162 Reclassi-fication	As Adjusted
								(millions)						
1	151	Land	$-	$ 1	$ 1.0	$ 1	$ 9.0	$ 10.0	$ 1	$	$ 1.0	$ 1	$	$ 1.0
2	152	Rights-of-way	-		-	1		1.0	-		-	-		-
3	153	Line Pipe	-		-	-		-	12	5.0	17.0	5	9.0	14.0
4	154	Line Pipe Fittings	-		-	4		4.0	9	6.0	15.0	22	18.0	40.0
5	155	Pipeline Construction	10	1	11.0	681	2.7	683.7	2,066	22.6	2,110.6	1,669	48.4	1,717.4
6	156	Buildings	1	1	2.0	23	24.7	47.7	73	29.6	102.6	101	49.6	150.6
7	157	Boilers	-		-	1		1.0	6	1.4	7.4	4	4.8	8.8
8	158	Pumping Equipment	-		-	6		6.0	29		29.0	33		33.0
9	160	Other Station Equipment	-	1	1.0	20	8.2	28.2	58	87.7	145.7	133	140.4	273.4
10	161	Oil Tanks	-	1	1.0	8	15.1	23.1	13	110.3	123.3	19	154.9	173.9
11	162	Delivery Facilities	6	(5)	1.0	66	(59.7)	6.3	329	(262.6)	66.4	540	(425.1)	114.9
12	163	Communication Systems	-		-	-		-	-		-	-		-
13	164	Office Furniture & Fixtures	-		-	-		-	-		-	-		-
14	165	Vehicles & Other Work Equip.	-		-	-		-	-		-	-		-

SCHEDULE E
Page 3b of 10

ARCO PIPE LINE COMPANY

TRANS ALASKA PIPELINE SYSTEM

ANALYSIS OF "AS-ADJUSTED" CONSTRUCTION EXPENDITURES

Line No.	Account No.	Description	(Col.25)	(Col.26) 1977	(Col.27)	(Col.28)
			As Reported by Alyeska	Account 162 Reclassi-fication	As Adjusted	Total as Adjusted at 6-31-77
					(millions)	
1	151	Land	$ -	$	$ -	$ 15.0
2	152	Rights-of-way	-		-	1.0
3	153	Line Pipe	-		-	155.0
4	154	Line Pipe Fittings	-		-	62.0
5	155	Pipeline Construction	550	24.1	574.1	5,253.8
6	156	Buildings	7	35.6	42.6	352.5
7	157	Boilers	-	3.1	3.1	20.3
8	158	Pumping Equipment	2		2.0	70.0
9	160	Other Station Equipment	238	79.5	317.5	777.8
10	161	Oil Tanks	1	91.0	92.0	414.3
11	162	Delivery Facilities	294	(233.3)	60.7	252.3
12	163	Communication Systems	3		3.0	3.0
13	164	Office Furniture & Fixtures	1		1.0	1.0
14	165	Vehicles & Other Work Equip.	50		50.0	50.0

Protest Reply of ARCO Pipe Line.

SCHEDULE F
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ARCO PIPE LINE COMPANY

TRANS ALASKA PIPELINE SYSTEM

ANALYSIS OF CONSTRUCTION EXPENDITURES AS REPORTED BY ATLESKA

Line Account No.	Acct. No.	Description	(Col. 1) 1969	(Col. 2) 1970	(Col. 3) 1971	(Col. 4) 1972	(Col. 5) 1973	(Col. 6) 1974	(Col. 7) 1975	(Col. 8) 1976	(Col. 9) 1977	(Col. 10) Total as of 8-31-77
							(millions)					
1	151	Land-										
2		Direct expenditures (p. 3, Line 1)	$ -	$ -	$ -	$ -	$ -	$ 1	$ 1	$ 1	$ -	$ 3
3		Engineering and G & A Overheads	-	-	-	-	-	-	-	-	-	-
4		Total	-	-	-	-	-	1	1	1	-	3
5	152	Rights-of-way-										
6		Direct expenditures (p. 3, Line 2)	-	-	-	-	-	1	-	-	-	1
7		Engineering and G & A Overheads	-	-	-	-	-	-	-	-	-	-
8		Total	-	-	-	-	-	1	-	-	-	1
9	153	Line Pipe-										
10		Direct expenditures (p. 3, Line 3)	14	83	38	-	-	-	12	3	-	141
11		Engineering and G & A Overheads	-	-	-	-	-	-	-	-	-	-
12		Total	14	83	38	-	-	-	12	3	-	141
13	154	Line Pipe Fittings-										
14		Direct expenditures (p. 3, Line 4)	-	-	3	-	-	4	9	22	-	38
15		Engineering and G & A Overheads	-	-	-	-	-	-	-	-	-	-
16		Total	-	-	3	-	-	4	9	22	-	38
17	155	Pipeline Construction-										
18		Direct expenditures (p. 3, Line 5)	12	78	46	29	33	681	2,088	1,469	332	5,171
19		Engineering and G & A Overheads	4	15	19	17	23	36	115	93	30	352
20		Total	16	93	65	36	33	717	2,203	1,562	30	5,523
21	156	Buildings-										
22		Direct expenditures (p. 3, Line 6)	1	1	1	-	1	23	73	111	7	218
23		Engineering and G & A Overheads	-	-	-	1	1	2	12	6	-	21
24		Total	1	1	1	1	2	25	85	117	7	239
25	157	Boilers-										
26		Direct expenditures (p. 3, Line 7)	-	-	-	-	-	1	6	4	-	11
27		Engineering and G & A Overheads	-	-	-	-	-	-	1	-	-	1
28		Total	-	-	-	-	-	1	7	4	-	12
29	158	Pumping Equipment-										
30		Direct expenditures (p. 3, Line 8)	-	-	-	-	-	7	29	32	4	72
31		Engineering and G & A Overheads	-	-	-	-	-	-	4	4	-	8
32		Total	-	-	-	-	-	7	33	36	4	80
33	160	Other Station Equipment-										
34		Direct expenditures (p. 3, Line 9)	-	-	-	4	4	21	122	173	238	562
35		Engineering and G & A Overheads	-	-	-	-	-	-	4	15	37	56
36		Total	-	-	-	4	4	21	126	188	275	618
37	161	Oil Tanks-										
38		Direct expenditures (p. 3, Line 10)	-	-	-	-	-	6	33	2	1	42
39		Engineering and G & A Overheads	-	-	-	-	-	-	3	3	-	6
40		Total	-	-	-	-	-	6	36	5	1	48
41	162	Delivery Facilities-										
42		Direct expenditures (p. 3, Line 11)	2	3	3	6	6	48	339	340	778	1,527
43		Engineering and G & A Overheads	1	-	-	-	-	1	11	13	21	47
44		Total	3	3	3	6	6	49	350	353	799	1,574
45	163	Communication System-										
46		Direct expenditures (p. 3, Line 12)	-	-	-	-	-	-	-	-	3	3
47		Engineering and G & A Overheads	-	-	-	-	-	-	-	-	-	-
48		Total	-	-	-	-	-	-	-	-	3	3
49	164	Office Furniture and Fixtures-										
50		Direct expenditures (p. 3, Line 13)	-	-	-	-	-	-	-	-	1	1
51		Engineering and G & A Overheads	-	-	-	-	-	-	-	-	-	-
52		Total	-	-	-	-	-	-	-	-	1	1
53	165	Vehicles and Other Work Equipment-										
54		Direct expenditures (p. 3, Line 14)	-	-	-	-	-	-	-	-	30	30
55		Engineering and G & A Overheads	-	-	-	-	-	-	-	-	-	-
56		Total	-	-	-	-	-	-	-	-	30	30
57		Total Direct expenditures										97,429
58		Total Engineering and G & A Overheads (p. 2, Line 19, Col. 10)										$ 847

Protest Reply of ARCO Pipe Line.

SCHEDULE F
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ARCO PIPE LINE COMPANY

TRANS ALASKA PIPELINE SYSTEM

ANALYSIS OF CONSTRUCTION EXPENDITURES AS REPORTED BY ATLESKA

(millions)

Line Account No.	Acct. No.	Description	(Col. 1) 1969	(Col. 2) 1970	(Col. 3) 1971	(Col. 4) 1972	(Col. 5) 1973	(Col. 6) 1974	(Col. 7) 1975	(Col. 8) 1976	(Col. 9) 1977	(Col. 10) Total as of 8-31-77
1	151	Land	$ -	$ -	$ -	$ -	$ -	$ 1	$ 1	$ 1	$ -	$ 3
2	153	Line Pipe	14	83	38	-	-	-	12	3	-	141
3	154	Line Pipe Fittings	-	-	3	-	-	4	9	22	-	38
4	155	Pipeline Construction	16	93	65	36	33	717	2,203	1,562	30	5,523
5	156	Buildings	1	1	1	1	2	25	85	117	7	239
6	157	Boilers	-	-	-	-	-	1	7	4	-	12
7	160	Other Station Equipment	-	-	-	4	4	21	126	188	275	618
8	161	Oil Tanks	-	-	-	-	-	6	36	5	1	48
9	162	Delivery Facilities	3	3	3	6	6	49	350	353	799	1,574
10	Subtotals	Applicable to Report	-	-	-	-	-	-	-	-	3	3
11		Construction Camps & Catering	-	-	-	-	-	-	-	-	1	1
12		Construction Equipment	-	-	-	-	-	-	-	-	30	30
13		Trans Alaska Construction	-	-	-	-	-	-	-	-	-	-
14		Total Direct expenditures	34	180	110	47	45	824	2,828	2,255	1,156	7,479
15		Total Engineering and G & A Overheads	5	15	19	18	24	39	126	99	30	375
16		Total	39	195	129	65	69	863	2,954	2,354	1,186	7,854

(1) Contents have been allocated to accounts 151-165 on a pro-rata basis

ARCO PIPE LINE COMPANY

TRANS ALASKA PIPELINE SYSTEM

SCHEDULE OF ORIGINAL COST (1980 EXPANSION)

1976-1980

Line No.	Account No.	Description	(Col. 1) 1978	(Col. 2) 1979	(Col. 3) 1980	(Col. 4) Total
			Construction Expenditures (millions)			
1	158	Pumping equipment	$48.0	$62.6	$25.9	$136.5 (To p. 2, Line 14, Col. 12)
		Overheads capitalized:				
2		Engineering				$ 4.6
3		General and Administrative				5.5
4		Interest during construction				12.7
5		Total overheads capitalized				$ 22.8 (To p. 2, Line 18, Col. 12)
6		Memo: Total cost excluding interest during construction (Lines 1, 2 and 3)				$146.6

ARCO PIPE LINE COMPANY

TRANS ALASKA PIPELINE SYSTEM

SCHEDULE OF WEIGHTED CONDITION PERCENTS
(Dollars in Millions)

Line No.		(Col. 1)	(Col. 2) 1977		(Col. 3)	(Col. 4) 1978		(Col. 5)	(Col. 6) 1979		(Col. 7)	(Col. 8) 1980		(Col. 9)	(Col. 10) 1981		(Col. 11)
		Condition Percent	CRV	CRVLD	Condition Percent	CRV	CRVLD	Condition Percent	CRV	CRVLD	Condition Percent	CRV	CRVLD	Condition Percent	CRV	CRVLD	Condition Percent
1	Pipe and Fittings	100.0%	$1,249.0	$1,249.0	94.0%	$1,249.0	$1,174.1	89.0%	$1,201.5	$1,202.9	84.0%	$1,439.9	$1,223.0	79.0%	$1,573.5	$1,243.1	
2	Buildings and Machinery	100.0	412.5	412.5	93.0	412.5	383.6	87.0	449.1	389.8	82.0	462.9	396.0	77.0	521.8	401.2	
3	Additions	-	-	-	-	-	-	-	-	-	-	-	-	100.0	339.3	339.3	
4			$1,661.5	$1,661.5		$1,661.5	$1,557.7		$1,799.6	$1,592.7		$1,930.0	$1,619.0		$2,234.6	$1,703.7	
5	Weighted Condition Percent (CRVLD divided by CRV) (to page 1)	100.0%			93.75%			88.56%			83.90%			76.42%			

Note: CRV is Cost of Reproduction New and CRVLD is CRV Less Depreciation.

Protest Reply of ARCO Pipe Line.

ARCO PIPE LINE COMPANY

TRANS ALASKA PIPELINE SYSTEM

SCHEDULE OF COST OF REPRODUCTION NEW (CRN)

1977-1981

(Dollars in millions)

SCHEDULE 6
Page 6 of 10

Line No.	Account No.	Description	(Col. 1) Expenditures Through 1977 at 1967 Prices (p. 9, Col. 11)	(Col. 2) 1977 Period Index (p. 10, Col. 9)	(Col. 3) 1977 CRN	(Col. 4) 1978 Period Index (p. 10, Col. 10)	(Col. 5) 1978 CRN	(Col. 6) 1979 Period Index (p. 10, Col. 11)	(Col. 7) 1979 CRN	(Col. 8) Expenditures as of 12/31/80 at 1967 Prices (p. 9, Col. 17)	(Col. 9) 1980 Period Index (p. 10, Col. 12)	(Col. 10) 1980 CRN
1	153	Line Pipe	$ 34.44	416	$ 60.07	453	$ 66.46	497	$ 71.77	$ 34.44	537	$ 77.51
2	154	Line Pipe Fittings	3.33	416	11.05	453	15.42	497	16.55	3.33	537	17.88
3	155	Pipeline Construction	499.44	287	1,377.09	330	1,269.26	334	1,367.53	499.44	361	1,478.00
4		Total Pipe & Fittings			$1,249.01		$1,351.54		$1,455.85			$1,573.39
5	156	Buildings	26.58	298	$ 77.61	311	$ 82.66	334	$ 88.78	26.58	361	$ 95.95
6	157	Boilers	1.26	347	4.37	372	4.69	399	5.03	1.26	430	5.42
7	158	Pumping Equipment	4.11	373	15.41	415	17.06	461	18.94	30.70	487	159.29
8	160	Other Station Equipment	41.19	344	142.29	432	177.94	466	191.99	41.19	503	207.19
9	161	Oil Tanks	20.30	419	86.71	474	96.22	511	103.73	20.30	552	112.06
10	162	Delivery Facilities	15.13	374	53.56	384	58.10	413	62.49	15.13	445	67.33
11	163	Communication System	0.22	307	.59	287	.63	309	.68	.22	334	.73
12	164	Office Furn. & Fixtures	0.08	344	.20	263	.21	281	.22	.08	304	.24
13	165	Veh. & Other Work Equip.	2.70	243	9.73	287	10.62	309	11.43	2.70	334	12.54
14		Total Buildings and Machinery			$ 432.47		$ 448.13		$ 482.85			$ 665.53

			1977		1978		1979		1980	
			Pipe & Fitting	Bldg. & Mach.	Pipe & Fitting	Bldg. & Mach.	Pipe & Fitting	Bldg. & Mach.	Pipe & Fitting	Bldg. & Mach.
15		Total CRN	$1,249.0	$432.5	$1,351.5	$448.1	$1,455.9	$482.9	$1,573.5	$660.5
16		Engineering Overheads 3.0% 4.2%	38.6	17.0	41.8	18.5	45.0	19.9	48.6	27.2
17		Total	$1,287.6	$449.5	$1,393.3	$466.6	$1,500.9	$502.8	$1,622.1	$687.7
18		G & A Overheads 3.9% 3.6%	51.4	15.9	55.6	16.8	59.9	18.1	64.7	24.8
19		Total	$1,339.0	$465.0	$1,448.9	$483.4	$1,560.8	$520.9	$1,686.8	$712.5
20		Interest During Construction at 12%	160.7	53.4	173.9	58.0	187.3	62.5	202.4	85.5
21		Total	$1,499.7	$498.4	$1,622.8	$541.4	$1,748.1	$583.4	$1,889.2	$798.0

SCHEDULE 6
Page 6 of 10

		1977	1978	1979	1980
22	Cost of Reproduction New: Pipe and Fittings	$1,249.0	$1,351.5	$1,455.9	$1,573.5
23	Buildings and Machinery	432.5	448.1	482.9	660.5
24	Overheads Capitalized	336.6	364.6	350.7	453.2
25	Total (To p. 1, line 2)	$2,018.1	$2,364.2	$2,331.5	$2,687.2

Protest Reply of ARCO Pipe Line.

ARCO PIPE LINE COMPANY

TRANS ALASKA PIPELINE SYSTEM

SUMMARY OF CONSTRUCTION EXPENDITURES AT 1967 PRICES

1977-1981

(Dollars in Millions)

SCHEDULE 6
Page 9 of 10

Line No.	Account No.	Description	(Col. 1) 1969	(Col. 2) 1970	(Col. 3) 1971	(Col. 4) Initial Construction 1972	(Col. 5) 1973	(Col. 6) 1974	(Col. 7) 1975	(Col. 8) 1976	(Col. 9) 1977	(Col. 10) Total	(Col. 11) ARCO's Pro	(Col. 12) 1978 Expansion 1978	(Col. 13) 1979	(Col. 14) 1980	(Col. 15) ARCO's Total as 12/31/80
1	153	Line Pipe							$ 17.0	$ 14.0							
2		Original Cost	$ 34.0	$ 42.0	$ 28.0				499	423							
3		Annual Index	393	390	313				$ 4.16	$ 3.31		$ 68.54	$ 34.44				$ 34.44
4		1967 Cost	$ 7.29	$ 13.00	$ 13.02												
5	154	Line Pipe Fittings															
6		Original Cost			$ 3.0			$ 4.0	$ 11.0	$ 18.0							
7		Annual Index			313			390	499	423							
8		1967 Cost			$ 1.48			$ 1.54	$ 3.67	$ 9.46		$ 19.89	$ 3.33				$ 3.33
9	155	Pipeline Construction															
10		Original Cost	$ 12.0	$ 78.0	$ 48.0	$ 59.0	$ 11.0	$683.9	$2,110.6	$1,357.4	$776.1						
11		Annual Index	169	176	191	264	419	312	349	284	307						
12		1967 Cost	$ 7.10	$ 44.32	$ 25.13	$ 9.35	$ 5.02	$282.33	$ 761.41	$ 601.72	$ 349.00	$1,949.73	$499.44				$499.44
13	156	Buildings															
14		Original Cost	$ 2.0	$ 2.0	$ 1.0		$ 2.0	$ 17.7	$ 102.6	$ 150.6	$ 12.6						
15		Annual Index	259	293	196		324	265	273	284	307						
16		1967 Cost	$ 1.39	$ 1.33	$ 0.51		$ 0.49	$ 10.00	$ 37.58	$ 53.03	$ 13.68	$ 122.39	$ 26.58				$ 26.58
17	157	Boilers															
18		Original Cost						$ 1.0	$ 7.4	$ 8.8	$ 3.1						
19		Annual Index						300	330	360	367						
20		1967 Cost						$ 0.33	$ 2.24	$ 2.39	$ 0.84	$ 6.00	$ 1.26				$ 1.26
21	158	Pumping Equipment															
22		Original Cost						$ 6.0	$ 29.0	$ 33.0	$ 2.0			$ 48.0	$ 62.6	$ 25.9	
23		Annual Index						249	345	384	415			448	484	523	
24		1967 Cost						$ 2.11	$ 6.41	$ 6.59	$ 0.48	$ 19.59	$ 4.11	$ 10.71	$ 12.93	$ 4.99	$ 30.93
25	160	Other Station Equipment															
26		Original Cost			$ 9.0	$ 2.0	$ 7.0	$ 28.2	$ 145.7	$ 273.4	$317.3						
27		Annual Index			249	290	293	300	273	309	439						
28		1967 Cost			$ 3.61	$ 1.03	$ 0.37	$ 9.10	$ 29.06	$ 64.07	$ 72.01	$ 196.35	$ 41.19				$ 41.19
29	161	Oil Tanks															
30		Original Cost				C 1.0	$ 1.0	$ 23.1	$ 123.3	$ 173.9	$ 92.0						
31		Annual Index				293	300	303	410	439	470						
32		1967 Cost				$ 0.56	$ 0.33	$ 6.48	$ 20.07	$ 39.58	$ 19.57	$ 86.49	$ 20.30				$ 20.30
33	162	Delivery Facilities															
34		Original Cost				$ 1.0	$ 1.0	$ 8.2	$ 66.4	$ 114.9	$ 60.7						
35		Annual Index				236	248	290	330	353	380						
36		1967 Cost				$ 0.42	$ 0.40	$ 2.66	$ 19.76	$ 30.44	$ 15.97	$ 69.65	$ 15.13				$ 15.13
37	163	Communication System															
38		Original Cost									$ 3.0						
39		Annual Index									284						
40		1967 Cost									$ 1.06	$ 1.06	$ 0.22				$ 0.22
41	164	Office Furniture & Fixtures															
42		Original Cost									$ 1.0						
43		Annual Index									259						
44		1967 Cost									$ 0.39	$ 0.39	$ 0.08				$ 0.08
45	165	Vehicles & Other Work Equipment															
46		Original Cost									$ 50.0						
47		Annual Index									284						
48		1967 Cost									$ 17.61	$ 17.61	$ 3.70				$ 3.70

SCHEDULE 6
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ARCO PIPE LINE COMPANY

TRANS ALASKA PIPELINE SYSTEM

SCHEDULE OF ANNUAL AND PERIOD INDICES

Line No.	Account No.	Description	(Col. 1) 1969	(Col. 2) 1970	(Col. 3) 1971	(Col. 4) 1972	(Col. 5) 1973	(Col. 6) 1974	(Col. 7) 1975	(Col. 8) 1976	(Col. 9) 1977	(Col. 10) 1978	(Col. 11) 1979	(Col. 12) 1980	(Col. 13) 1981
1	153	Line Pipe Annual Indices	193	200	215	219	235	299	409	423	457	494	536	577	622
2		Period Indices (A)									416	463	497	537	
3	154	Line Pipe Fittings Annual Indices	193	200	215	219	235	299	409	423	457	494	536	577	622
4		Period Indices (A)									416	463	497	537	
5	155	Pipeline Construction Annual Indices	165	176	191	204	219	242	269	284	307	332	359	388	418
6		Period Indices (A)									287	310	334	361	
7	156	Buildings Annual Indices	219	225	196	206	224	265	273	284	307	332	359	388	418
8		Period Indices (A)									292	311	334	361	
9	157	Boilers Annual Indices	200	203	221	232	250	300	330	340	367	396	428	462	498
10		Period Indices (A)									347	372	399	430	
11	158	Pumping Equipment Annual Indices	226	230	236	244	253	285	325	364	419	448	484	523	564
12		Period Indices (A)									375	415	451	487	
13	160	Other Station Equipment Annual Indices	233	241	249	259	273	310	373	397	429	463	500	540	582
14		Period Indices (A)									394	432	466	503	
15	161	Oil Tanks Annual Indices	229	253	274	293	300	361	410	429	470	508	549	593	639
16		Period Indices (A)									437	474	511	552	
17	162	Delivery Facilities Annual Indices	210	223	225	236	248	290	336	352	380	410	443	478	515
18		Period Indices (A)									354	384	413	445	
19	163	Communications Systems Annual Indices	187	192	198	204	213	233	249	263	284	307	332	359	387
20		Period Indices (A)									267	287	309	334	
21	164	Office Furniture & Fixtures Annual Indices	169	172	177	179	188	207	236	240	259	280	302	326	351
22		Period Indices (A)									244	263	281	304	
23	165	Vehicles & Other Work Equip. Annual Indices	171	179	186	191	196	218	250	263	284	307	332	359	387
24		Period Indices (A)									263	287	309	334	

(A) Period Indices are computed by averaging 3 prior years', the current year's and 1 future year's Annual Indices.

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Protest Reply of ARCO Pipe Line.

Protest Reply of ARCO Pipe Line.

[Omitted (reproduced in Volume 3)]

BEFORE THE
INTERSTATE COMMERCE COMMISSION
DOCKET NO. 36611
TRANS ALASKA PIPELINE SYSTEM

VERIFIED STATEMENT OF JOHN A. JETER
REGARDING TREATMENT OF INTEREST
AS AN OPERATING EXPENSE

My name is John A. Jeter. I am a certified public accountant and, since 1954, have been associated with Arthur Andersen & Co., a firm of independent public accountants. I am presently a partner in that firm and am in charge of the firm's audit practice in Omaha, Nebraska.

At the request of counsel for ARCO Pipe Line Company, I undertook to analyze the data accompanying the letters of November 10, 1975, and March 22, 1976, from George M. Stafford, then Chairman of the Interstate Commerce Commission ("ICC" or "Commission"), to William L. Hungate, Chairman of the Subcommittee on Activities of Regulatory Agencies of the House Committee on Small Business (the letters and accompanying data, hereinafter collectively referred to as the "Stafford letters," appear at Appendix B). All work and calculations described in this statement were performed by me or by persons working at my direction.

From the list of pipeline companies for whom data is set forth in the Stafford letters, the five owner companies or affiliates of owners of the Trans Alaska Pipeline System listed therein, and 13 other major pipeline companies, were selected for analysis. Copies of Schedule 302 of the Annual Reports, Form P, for the years 1970-1973, inclusive, were then obtained from the ICC files for each of the 18 companies selected, except in three cases where the records custodian was unable to locate the Annual Reports. The dollar amounts provided at lines 5 and 10 of Schedule 302

(shown as "Net carrier operating income" and "Interest expense," respectively) were then used on Schedule A, attached hereto.

Using the data obtained from the Annual Reports, computations of net income (or loss) were made with interest treated as an operating expense. These figures, which appear in Column 5 of Schedule A, were then compared with the corresponding "Net Income (or loss)" figures shown in the Stafford letters (the figures from the Stafford letters are reproduced in Column 6 of Schedule A). In all 68 cases, the computed amounts agree with the "Net Income (or loss)" figures from the Stafford letters.

It is evident from this analysis that, in the Stafford letters, interest was treated as an operating expense in computing income or loss and rates of return on valuation.

SCHEDULE A
Page 1 of 4

RATE OF RETURN ON VALUATION

SELECTED OIL PIPE LINE COMPANIES

1972

Company	(Col. 1) Form P Schedule 302 Line 9 Net Carrier Operating Income	(Col. 2) Form P Schedule 302 Line 10 Interest Expense	(Col. 3) Total (Col. 1 - Col. 2)	(Col. 4) Income Tax (Col. 3 x 48.0%)	(Col. 5) Net Income (or Loss) (Col. 3 - Col. 4)	(Col. 6) ICC Letter to Congress (Note 1)
Amoco Pipeline Company	$31,401	$ 812	$30,589	$14,683	$15,906	$15,906
ARCO Pipe Line Company	11,983	570	11,410	5,477	5,933	5,933
Cities Service Pipe Line Company	2,729	79	2,650	1,272	1,378	1,378
Colonial Pipeline Company	51,616	16,329	35,287	16,938	18,349	18,349
Dixie Pipeline Company	6,383	1,844	4,536	2,177	2,359	2,359
Exxon Pipeline Company (Note 2)	31,996	5,101	26,895	12,910	13,985	13,985
Gulf Refining Company	9,148	-	9,148	4,391	4,757	4,757
Laurel Pipe Line Company	3,497	1,543	1,954	938	1,016	1,016
Mobil Pipe Line Company	18,546	5,064	13,482	6,471	7,011	7,011
Phillips Pipe Line Company	12,339	118	12,221	5,866	6,355	6,355
Platte Pipe Line Company	6,929	993	5,934	2,848	3,086	3,086
Pure Transportation Company	5,542	1,223	4,319	2,073	2,246	2,246
Shell Pipe Line Corp.	21,573	4,506	17,067	8,192	8,875	8,875
Sohio Pipe Line Company	1,470	-	1,470	706	764	764
Sun Pipe Line Company	4,672	599	4,273	2,051	2,222	2,222
Texas Pipe Line Company	21,043	4,223	16,818	8,073	8,745	8,745
Texas - New Mexico Pipe Line	6,431	647	5,784	2,776	3,008	3,008
Williams Pipe Line Company (Note 3)	N/A	N/A				7,099

Notes:

(1) Letter dated November 10, 1975, from Mr. George M. Stafford, Chairman, Interstate Commerce Commission to Mr. William L. Hungate, Chairman, Subcommittee on Activities of Regulatory Agencies, Committee on Small Business, House of Representatives.

(2) Name changed from Humble Pipe Line Company to Exxon Pipeline Company January 1, 1973.

(3) Name changed from Williams Brothers Pipe Line Company.

SCHEDULE A
Page 1 of 4

SCHEDULE A
Page 2 of 4

RATE OF RETURN ON VALUATION

SELECTED OIL PIPE LINE COMPANIES

1971

Company	(Col. 1) Form P Schedule 302 Line 9 Net Carrier Operating Income	(Col. 2) Form P Schedule 302 Line 10 Interest Expense	(Col. 3) Total (Col. 1 - Col. 2)	(Col. 4) Income Tax (Col. 3 x 48.0%)	(Col. 5) Net Income (or Loss) (Col. 3 - Col. 4)	(Col. 6) ICC Letter to Congress (Note 1)
Amoco Pipeline Company	$32,126	$ 837	$31,289	$15,019	$16,270	$16,270
ARCO Pipe Line Company	13,977	454	13,523	6,491	7,032	7,032
Cities Service Pipe Line Company	3,126	76	3,050	1,464	1,586	1,586
Colonial Pipeline Company	52,648	17,456	35,191	16,891	18,300	18,300
Dixie Pipeline Company	6,810	1,873	4,937	2,370	2,567	2,567
Exxon Pipeline Company (Note 2)	29,033	5,653	23,380	11,222	12,158	12,158
Gulf Refining Company	8,830	844	7,986	3,833	4,153	4,153
Laurel Pipe Line Company	2,758	1,442	1,316	632	684	684
Mobil Pipe Line Company	19,951	5,118	14,833	7,120	7,713	7,713
Phillips Pipe Line Company	11,829	109	11,720	5,626	6,094	N/A
Platte Pipe Line Company	6,052	808	5,244	2,517	2,727	2,727
Pure Transportation Company	N/A	N/A				2,990
Shell Pipe Line Corp.	22,258	4,764	17,494	8,397	9,097	9,097
Sohio Pipe Line Company	2,158	-	2,158	1,036	1,122	1,122
Sun Pipe Line Company	7,058	360	6,698	3,215	3,483	3,483
Texas Pipe Line Company	19,655	2,324	17,331	8,319	9,012	9,012
Texas - New Mexico Pipe Line	5,681	649	5,032	2,415	2,617	2,617
Williams Pipe Line Company (Note 3)	26,761	13,315	13,446	6,454	6,992	6,992

Notes:

(1) Letter dated November 10, 1975, from Mr. George M. Stafford, Chairman, Interstate Commerce Commission to Mr. William L. Hungate, Chairman, Subcommittee on Activities of Regulatory Agencies, Committee on Small Business, House of Representatives.

(2) Name changed from Humble Pipe Line Company to Exxon Pipeline Company January 1, 1973.

(3) Name changed from Williams Brothers Pipe Line Company.

SCHEDULE A
Page 2 of 4

SCHEDULE A
Page 3 of 4

RATE OF RETURN ON VALUATION

SELECTED OIL PIPE LINE COMPANIES

1972

Company	(Col. 1) Form P Schedule 302 Line 5 Net Carrier Operating Income	(Col. 2) Form P Schedule 302 Line 10 Interest Expense	(Col. 3) Total (Col. 1 - Col. 2)	(Col. 4) Income Tax (Col. 3 x 48.0%)	(Col. 5) Net Income (or Loss) (Col. 3 - Col. 4)	(Col. 6) ICC Letter to Congress (Note 1)
Amoco Pipeline Company	$32,377	$ 2,552	$29,825	$14,316	$15,509	$15,509
ARCO Pipe Line Company	11,676	338	11,338	5,442	5,896	5,896
Cities Service Pipe Line Company	2,889	90	2,799	1,344	1,455	1,455
Colonial Pipeline Company	57,920	24,427	33,493	16,077	17,416	17,416
Dixie Pipeline Company	7,908	1,994	5,914	2,839	3,075	3,075
Exxon Pipeline Company (Note 2)	34,217	5,747	28,470	13,666	14,804	14,804
Gulf Refining Company	10,574	4	10,570	5,074	5,496	5,496
Laurel Pipe Line Company	1,856	1,341	515	247	268	268
Mobil Pipe Line Company	18,133	4,844	13,289	6,379	6,910	6,910
Phillips Pipe Line Company	11,773	106	11,667	5,600	6,067	6,067
Platte Pipe Line Company	6,060	752	5,308	2,548	2,760	2,760
Pure Transportation Company	6,991	1,125	5,866	2,816	3,050	3,050
Shell Pipe Line Corp.	23,019	7,098	15,921	7,642	8,279	8,279
Sohio Pipe Line Company	2,602	-	2,602	1,249	1,353	1,353
Sun Pipe Line Company	9,057	561	8,496	4,078	4,418	4,418
Texas Pipe Line Company	14,793	2,265	12,528	6,013	6,515	6,515
Texas - New Mexico Pipe Line	5,828	572	5,256	2,523	2,733	2,733
Williams Pipe Line Company (Note 3)	27,769	12,716	15,053	7,225	7,828	7,828

Notes:

(1) Letter dated November 10, 1975, from Mr. George M. Stafford, Chairman, Interstate Commerce Commission to Mr. William L. Hungate, Chairman, Subcommittee on Activities of Regulatory Agencies, Committee on Small Business, House of Representatives.

(2) Name changed from Humble Pipe Line Company to Exxon Pipeline Company January 1, 1973.

(3) Name changed from Williams Brothers Pipe Line Company.

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SCHEDULE A
Page 4 of 4

RATE OF RETURN ON VALUATION

SELECTED OIL PIPE LINE COMPANIES

1973

Company	(Col. 1) Form P Schedule 302 Line 5 Net Carrier Operating Income	(Col. 2) Form P Schedule 302 Line 10 Interest Expense	(Col. 3) Total (Col. 1 - Col. 2)	(Col. 4) Income Tax (Col. 3 x 48.0%)	(Col. 5) Net Income (or Loss) (Col. 3 - Col. 4)	(Col. 6) ICC Letter to Congress (Note 1)
Amoco Pipeline Company	$32,800	$ 2,811	$29,989	$14,395	$15,594	$15,594
ARCO Pipe Line Company	13,198	222	12,976	6,228	6,748	6,748
Cities Service Pipe Line Company	3,364	319	3,045	1,462	1,583	1,583
Colonial Pipeline Company	60,965	24,559	36,406	17,475	18,931	18,931
Dixie Pipeline Company	6,299	2,009	4,290	2,059	2,231	2,231
Exxon Pipeline Company (Note 2)	38,035	7,361	3,0674	14,724	15,950	15,950
Gulf Refining Company	11,176	1	11,175	5,364	5,811	5,811
Laurel Pipe Line Company	2,746	1,240	1,506	723	783	783
Mobil Pipe Line Company	18,946	5,461	13,485	6,473	7,012	7,012
Phillips Pipe Line Company	10,928	99	10,829	5,198	5,631	5,631
Platte Pipe Line Company	7,347	781	6,566	3,169	3,414	3,414
Pure Transportation Company	N/A	N/A				2,680
Shell Pipe Line Corp.	23,190	7,137	16,053	7,705	8,348	8,348
Sohio Pipe Line Company	2,410	-	2,410	1,157	1,253	1,253
Sun Pipe Line Company	8,912	169	8,743	4,197	4,546	4,546
Texas Pipe Line Company	17,085	3,653	13,432	6,447	6,985	6,985
Texas - New Mexico Pipe Line	6,119	556	5,563	2,670	2,893	2,893
Williams Pipe Line Company (Note 3)	28,658	12,117	16,541	7,940	8,601	8,601

Notes:

(1) Letter dated November 10, 1975, from Mr. George M. Stafford, Chairman, Interstate Commerce Commission to Mr. William L. Hungate, Chairman, Subcommittee on Activities of Regulatory Agencies, Committee on Small Business, House of Representatives.

(2) Name changed from Humble Pipe Line Company to Exxon Pipeline Company January 1, 1973.

(3) Name changed from Williams Brothers Pipe Line Company.

SCHEDULE A
Page 4 of 4

Protest Reply of ARCO Pipe Line.

VERIFICATION

District of Columbia } ss:

John A. Jeter, being duly sworn, deposes and says that he has read the foregoing statement, knows the contents thereof, and that the same are true as stated.

JOHN A. JETER

Subscribed and sworn to before me
this 22nd day of June, 1977.

SHIRLEY C. PURVIS
Notary Public
of the District of Columbia

My commission expires: April 14, 1980

Protest Reply of ARCO Pipe Line.

BEFORE THE
INTERSTATE COMMERCE COMMISSION
DOCKET NO. 36611
TRANS ALASKA PIPELINE SYSTEM

VERIFIED STATEMENT OF ROBERT L. HUSTON

My name is Robert L. Huston. I am Senior Vice President of White, Weld & Co. Incorporated ("White, Weld"). White, Weld is an international investment banking firm with offices throughout the United States and in major cities abroad. Our clients include corporations from all sectors of industry, and our staff of corporate finance specialists working with these clients exceeds seventy in number. My personal background includes twenty-one years in oil, gas and minerals financing. Project financing in which I have been deeply involved covers uranium, coal, shipping, refineries and pipelines, as well as oil and gas production financing.

Matters Reviewed

At the request of counsel for ARCO Pipe Line Company ("ARCO Pipe Line"), we have set forth briefly in the following pages the views of White, Weld with respect to (i) the rate of return which, under the proposed $6.04 per barrel tariff, ARCO Pipe Line may expect to earn on its investment in the Trans Alaska Pipeline System ("TAPS" or the "System"), and (ii) the reasonableness of such a return. In conducting our analysis and arriving at our conclusions, we have relied upon a number of factors, including:

(1) An understanding of the valuation and rate of return methodology employed by the Interstate Commerce Commission;

(2) A review of the documents submitted to date by the various protestants;

(3) The financing of ARCO Pipe Line's undivided interest ownership in TAPS and its relationship to the overall capital structure of Atlantic Richfield;

(4) The accumulated experience of White, Weld with respect to the underwriting and marketing of securities in capital markets around the world;

(5) The rate of return calculations provided for ARCO Pipe Line by John A. Jeter of Arthur Andersen & Co. (Appendix F); and

(6) Returns on equity which have been earned by companies in capital-intensive industries (see Exhibit 1 hereto).

Discussion

Papers filed to date in protest of the proposed ARCO Pipe Line tariff have suggested, among other things, that approval of such a tariff would permit an excessive rate of return on equity, asserted by one protestant, the State of Alaska, to be 66.0%. Aside from the obvious fact that ICC methodology does not address the issue of return on equity, we believe that the protestants have based their conclusions on several mistaken assumptions which distort the financial realities of TAPS. Among these unstated assumptions, the most important are the following:

(1) That TAPS was essentially a project financing, whereby the underlying economics of the System alone permitted the pipeline companies involved to finance their respective investments through the issuance of a high percentage of debt;

(2) That the employment of debt financing for ARCO Pipe Line had no relation to Atlantic Richfield's ability to undertake other projects; and

(3) That ARCO Pipe Line's rate of return calculation is unrelated to the debt and equity capitalization of Atlantic Richfield.

We believe that refutation of these assumptions is a necessary prerequisite to a fair evaluation of the appropriateness of the proposed tariff:

(A) Project financing, in terms of ARCO Pipe Line's share of TAPS, would have involved ARCO Pipe Line financing its portion of TAPS costs based on the economic merits of the project alone. The risks involved in TAPS exceeded those in normal project financings, especially in regard to the lack of producing history to substantiate the oil reserve estimates, unknown future wellhead pricing, and uncertain construction costs and costs of production. Because of the risks involved, it would not have been possible for ARCO Pipe Line to raise the necessary capital based solely on its own credit and its future cash flow. In order to finance its capital cost of the System, ARCO Pipe Line had to rely on the credit standing of Atlantic Richfield. The fact that ARCO Pipe Line issued debt guaranteed by Atlantic Richfield to finance its participation in TAPS emphasizes the necessity of viewing the issue of a reasonable return on equity in the context of the consolidated capital structure of Atlantic Richfield.

(B) The assumption that TAPS was project financed and could, by definition, support a high level of debt on the basis of the economics of the System ignores any consideration of the opportunity cost to Atlantic Richfield of participating in the financing of TAPS. In the overall context of the business of Atlantic Richfield and its subsidiaries, TAPS repre-

sents only one among numerous actual or potential projects. The fact is that the debt of ARCO Pipe Line was only marketable with an Atlantic Richfield guarantee. If ARCO Pipe Line's cash flow is insufficient to meet its debt maturities, Atlantic Richfield is required to make the payments from its own funds. This fact is considered by the rating agencies and the financial community in their evaluation of Atlantic Richfield's creditworthiness when it seeks debt funds for other projects.

(C) Typically, the purchasers of corporate debt securities are insurance companies, pension funds, savings banks and the public. In making their investment decision, these investors rely on several measures of credit standing. One measure is the percentage of balance sheet term debt in a company's total debt and equity capitalization. Another measure is the ratio of a company's pre-tax earnings to its fixed annual charges, primarily interest on its debt. The percentage of debt in the total capitalization of ARCO Pipe Line as of December 31, 1976, and its coverage of fixed charges as of that date, were 89% and 0.26, respectively. Given the prospect of this high debt ratio and of the unusually low coverage of fixed charges, and the attendant risks associated with TAPS, it is our judgment that investors would not have considered the purchase of ARCO Pipe Line's debt issue without either a direct guarantee from Atlantic Richfield Company or other assurances of debt repayment, such as might be provided for in the form of throughput agreements. In point of fact, Atlantic Richfield's equity position and earnings power were unequivocally the keys to ARCO Pipe Line's ability to invest in TAPS. To calculate, as do protestants, an earnings return on

ARCO Pipe Line's book figures, which in turn depend on the resources of Atlantic Richfield, is an exercise which lacks significance.

Conclusion

It is sufficiently clear to us, as financial advisors, that to measure the return on equity without reference to the capital structure of Atlantic Richfield is a distortion of financial reality. The TAPS project risks were such that it was necessary for Atlantic Richfield to guarantee the debt of ARCO Pipe Line. The guarantee provided marketability to ARCO Pipe Line's debt, but Atlantic Richfield's ability to issue additional debt for other projects was reduced by the guarantee. The credit standing of the parent company, its earning power, and particularly its capital account, were the cornerstones for ARCO Pipe Line's financing. The capital ratio of Atlantic Richfield is the appropriate framework for the earnings measurement of ARCO Pipe Line.

It is quite evident that after adjusting the capitalization of ARCO Pipe Line to reflect the ratio of debt to total capital of Atlantic Richfield, the return on equity is consistent with the rate of return on equity forecast for new projects being undertaken by capital-intensive corporations. Generally speaking, for a new investment a company seeks an after-tax earnings return on equity in excess of its current rate of return, since to invest at a lower return will adversely affect earnings growth over a period of time. For purposes of comparison, we have attached as Exhibit I a summary of the returns on book equity earned in 1976 by companies in capital-intensive industries.

The $6.04 tariff will provide for an average return on book equity of 15.2% through 1981 (see Appendix F). In the judgment of White, Weld, this return is modest in view of the risks of the TAPS project.

Protest Reply of ARCO Pipe Line.

EXHIBIT 1

1976 Return on Stockholders' Equity for Companies Engaged in the Manufacture of Chemicals
($ in Thousands)

	Net Income	Stockholders' Equity	Return on Stockholders' Equity
Nalco Chemical	$ 43,364	$ 183,251	23.77%
International Minerals & Chemicals	135,400	580,700	23.32
Dow Corning	42,741	197,412	21.65
Dow Chemical	612,767	2,865,010	21.39
Diamond Shamrock	140,030	671,642	20.85
Lubrizol	50,957	261,633	19.48
Stauffer Chemical	113,016	597,043	18.93
Clorox	27,262	151,034	18.05
Air Products & Chemicals	63,479	362,813	17.50
Kewanee Industries	35,398	213,019	16.62
National Starch & Chemical	24,486	149,259	16.41
Monsanto	366,300	2,252,300	16.26
Koppers	66,841	424,419	15.75
Insilco	19,616	129,984	15.21
PPG Industries	151,500	1,021,600	14.83
Ethyl	69,080	475,884	14.52
Airco	54,003	372,458	14.50
Union Carbide	441,200	3,055,100	14.44
Hercules	106,801	742,020	14.39
Witco Chemical	23,062	162,801	14.17
Ferro	20,054	143,960	13.93
National Distillers & Chemical	90,288	672,976	13.42
Inmont	20,108	163,387	12.31
Am[illegible]n Cyanamid	135,766	1,109,169	12.24
[illegible]nwalt	34,910	285,780	12.22
Olin	72,563	594,387	12.21
W.R. Grace	131,882	1,155,342	11.41
DuPont	459,300	4,039,200	11.37
Cabot	29,373	264,637	11.10
Reichhold Chemicals	16,085	149,196	10.78
NL Industries	58,836	553,754	10.62
Allied Chemical	116,799	1,114,288	10.48
SCM	30,395	313,643	9.69
Williams Companies	61,196	676,634	9.04
Celanese	69,000	796,000	8.67
Chemetron	13,400	212,000	6.32
Sherwin-Williams	18,435	302,066	6.10
Akzona	5,622	306,594	1.83
Rohm & Haas	(11,777)	501,223	(2.35)
Morton-Norwich Products	(6,639)	219,837	(3.03)
AVERAGE	$ 98,827	$ 711,067	13.90%

Protest Reply of ARCO Pipe Line.

1976 Return on Stockholders' Equity for Companies Engaged in Mining and Crude Oil Production
($ in Thousands)

	Net Income	Stockholders' Equity	Return on Stockholders' Equity
MAPCO	$ 56,126	$ 203,033	27.64%
Westmoreland Coal	48,232	189,679	25.43
Louisiana Land & Exploration	96,744	397,589	24.33
Pittston	146,372	602,887	24.28
Pennzoil	167,659	704,798	23.79
Natomas	57,112	270,270	21.13
Eastern Gas & Fuel Associates	65,731	337,926	19.45
Vulcan Materials	37,247	201,176	18.51
St. Joe Minerals	68,748	415,773	16.53
Hanna Mining	53,757	340,635	15.78
Belco Petroleum	31,355	199,222	15.74
Occidental Petroleum	183,721	1,305,276	14.08
Getty Oil	258,475	2,157,224	11.98
AMAX	150,080	1,566,050	9.58
Texasgulf	62,914	795,393	7.91
Peabody Coal	30,815	928,456	3.32
AVERAGE	$ 94,693	$ 663,462	14.27%

Protest Reply of ARCO Pipe Line.

1976 Return on Stockholders' Equity for Companies Engaged in Petroleum Refining
($ in Thousands)

	Net Income	Stockholders' Equity	Return on Stockholders' Equity
Continental Oil	$ 459,994	$ 2,635,444	17.45%
Marathon Oil	195,808	1,150,527	17.02
Ashland Oil	135,983	808,973	16.81
Shell Oil	705,838	4,591,182	15.37
Phillips Petroleum	411,656	2,720,341	15.13
Kerr-McGee	134,132	913,104	14.69
Crown Central Petroleum	12,092	82,706	14.62
Standard Oil (Indiana)	892,968	6,146,705	14.53
Tenneco	383,500	2,651,000	14.47
Exxon	2,640,964	18,470,352	14.30
Atlantic Richfield	575,178	4,091,133	14.06
Quaker State Oil Refining	25,748	184,735	13.94
Sun	356,182	2,555,069	13.94
Amerada Hess	152,637	1,161,843	13.14
Murphy Oil	48,903	379,531	12.89
Union Oil	268,815	2,103,815	12.78
Standard Oil of California	880,127	7,007,013	12.56
Mobil	942,523	7,651,811	12.32
Cities Service	217,000	1,798,200	12.07
American Petrofina	45,549	387,053	11.77
Gulf Oil	816,000	6,942,000	11.75
Tosco	7,959	67,862	11.73
Charter	16,862	146,409	11.52
Texaco	869,731	9,002,007	9.66
Clark Oil & Refining	9,439	106,393	8.87
Standard Oil (Ohio)	136,857	1,549,302	8.83
Tesoro Petroleum	28,799	359,232	8.02
Commonwealth Oil Refining	(32,085)	145,482	(22.05)
AVERAGE	$ 404,970	$ 3,064,615	13.21%

Protest Reply of ARCO Pipe Line.

VERIFICATION

District of Columbia) ss:

Robert L. Huston, being duly sworn, deposes and says that he has read the foregoing statement, knows the contents thereof, and that the same are true as stated.

ROBERT L. HUSTON

Subscribed and sworn to before me
this 22nd day of June, 1977.

SHIRLEY C. PURVIS

Notary Public
of the District of Columbia

My commission expires: April 14, 1980

Protest Reply of ARCO Pipe Line.

BEFORE THE
INTERSTATE COMMERCE COMMISSION

DOCKET NO. 36611
TRANS ALASKA PIPELINE SYSTEM

COMMENTS ON PETITIONS SEEKING SUSPENSION OF INITIAL RATES FOR TRANSPORTATION OF PETROLEUM VIA TRANS ALASKA PIPELINE SYSTEM

Verified Statement of
J. Rhoads Foster

Foster Associates, Inc.
Washington, D.C. 20036
June 22, 1977

Protest Reply of ARCO Pipe Line.

My name is J. Rhoads Foster. My address is 1101 Seventeenth Street, Northwest, Washington, D.C. 20036. I am an economist and a senior consultant with Foster Associates, Inc., an independent consulting firm of which I am the founder.

Foster Associates offers economic research and consulting services to governmental agencies, industry groups, and individual companies in the United States and Canada. The principal areas of consulting activity include energy, public utilities, transportation, communications, the securities business and the postal service. Assignments within these areas of activity involve many issues and problems, including supply of and demand for products or services, pricing, methods of governmental regulation, proposed legislation, cost of capital, fair rate of return, financial feasibility, cost analysis, valuation of property and industry structure.

I received a doctorate in political economy from the University of Missouri in 1933 and was first employed (1933-1936) by Consolidated Edison Company (then New York Edison Company) as Special Assistant to the Rate Engineer. From 1937 to 1942 I was Economist and Director of Special Investigations, Board of Public Utility Commissioners, State of New Jersey. On leave of absence, in 1937-1938, I was employed by the Federal Communications Commission to make cost of capital and fair rate of return studies in connection with the Commission's first general investigation of the Bell System. I taught courses in public utility economics, ratemaking, principles of valuation, regulatory procedures and public utility law in the Graduate School of Business Administration and the School of Law, New York University, on a part-time basis (1937-1952). I am co-author of Foster and Rodey, *Public Utility Accounting* (Prentice-Hall, 1951) and of many articles and mono-

graphs. I have been a member of the New York Society of Security Analysts for about 40 years and am a past Chairman of the Committee on Corporate Finance, National Association of Railroad and Utilities Commissioners.

My employment to make cost of capital and fair rate of return studies has been continuous since 1937, with assignments from governmental agencies, trade associations and companies in nonregulated as well as regulated industries. I have made cost of capital studies for gas transmission companies, gas distributors, combination electric and gas companies, electric companies, telephone companies, airline companies, shipping companies, railroads, oil pipeline companies and local transportation companies. I have made submissions to legislative and judicial bodies and, on one or many occasions, to more than 35 regulatory agencies in the United States and Canada. My submissions to the Interstate Commerce Commission on cost of capital and fair rate of return issues have been on behalf of the Association of American Railroads in *Ex Parte Nos.* 271, 274 (Sub-No. 2) and 338 and, on behalf of Burlington-Northern and Southern Pacific, in Docket No. 36,180.

The United States Department of Justice, the Bureau of Investigations and Enforcement (Interstate Commerce Commission), the State of Alaska and the Arctic Slope Regional Corporation directed protests at the initial tariff rates filed for the transportation of liquid hydrocarbons by carriers holding an ownership interest in the Trans-Alaska Pipeline System (TAPS). Each of the protestants requests the Commission to suspend the published tariffs and permit the carriers to file, on short notice, revised tariffs which would establish the transportation rates at

levels consistent with rates asserted by the protestants to be reasonable.

Rates proposed by the Department of Justice vary from $3.74 to $4.88 per barrel. The variance is with equity ratios attributed to the individual carriers and with other cost differences. The proposed rates are substantially below rates in the range of $6.04 to $6.44 filed by the carriers. Rates deemed proper by the Bureau of Investigations and Enforcement vary from $4.54 to $5, while the State of Alaska proposes maximum interim rates in the $3.59 to $4.42 range. Requests are that refilings be subject to refund provisions and a continuing investigation into the reasonableness of the proposed rates. For example, the Department of Justice requests the Commission "to institute an investigation into the lawfulness of such rates, such investigation to include an analysis of ratemaking methodology, allowed rate of return, and reasonableness of costs incurred or claimed."

ARCO Pipe Line Company has asked me to review the submissions made by each of the protestants and to determine whether or not, in my opinion, the rates filed by the protestants are *prima facie* reasonable and whether or not the rate filed by the carrier is, as contended by the protestants, clearly excessive, unjust and unreasonable.

My analysis is directed to the cost of capital component of the total cost of transportation. I have made no study and have no opinion regarding other cost components of the tariff rates. Moreover, this submission is limited to a preliminary analysis of available information. I do not reach an opinion regarding the cost of capital and return which may be finally determined to be just and reasonable. For the purpose of the analyses set out in this submission I accept the factual data as distinguished from judgments or conclusions contained in the petitions and complaints.

I did not advise ARCO Pipe Line or other carriers as to what should be the cost of capital component of proposed tariff rates.

The protestants have identified a wide range of complex issues, including cost of capital and reasonable equity earnings, costs of construction and design of TAPS, interests charges during construction, annual depreciation and amortization charges, prospective removal costs and normalization versus flow through of deferred income taxes. The Bureau of Investigations and Enforcement lists still other issues which are now under active review by Touche Ross & Co. but on which Touche Ross has not yet reported. It appears evident that these issues cannot be resolved by informed decisions on the basis of summary hearings. Because of the issues presented with regard to standards and procedures for pipeline regulation, the generic hearing concept is relevant. I believe that reconsideration of regulatory standards and procedures for the pipeline industry is likely to be more productive if undertaken in a general hearing or investigation, such as *Ex Parte* No. 308, instead of in summary hearings. The Commission has adopted this hearing process in dealing with railroad industry problems arising under the 4 R's Act. Many other federal and state regulatory commissions have used this type of hearing process to establish policies and standards.[1]

The complexity of the issues is indicated by the errors of analysis and computation made by the Department of Justice and the State of Alaska.

1. For example, *Re Rate Design for Electric Corporations,* 15 PUR 4th, 434, 8-10-76 (New York Public Service Commission); *Re Adjustment Clauses in Telephone Rate Schedules,* 3 PUR 4th, 298, 12-13-73 (New Jersey Board of Public Utility Commissioners); *Accounting and Construction Work in Progress and Funds Used for Construction,* 9 PUR 4th, 394, 4-28-75 (Florida Public Service Commission).

The primary error lies in the assumption, contrary to fact, that with respect to financial risk and cost of debt and equity capital ARCO Pipe Line stands on its own feet independently of its parent, Atlantic Richfield.

The equity of ARCO Pipe Line is wholly-owned by Atlantic Richfield. The debt capital obtained by ARCO Pipe Line from external sources is unconditionally guaranteed by Atlantic Richfield as to payment of principal and interest. Neither the contractual cost of ARCO Pipe Line's long-term debt nor yields at market price measure what would have been, in the absence of the commitments by Atlantic Richfield, the cost of debt capital committed by ARCO Pipe Line to the construction of TAPS. A substantial portion of the cost of risk taking is borne by the owners of Atlantic Richfield. In other words, the credit of the owners and their debt capacity is transferred to ARCO Pipe Line. The guarantee is equivalent to a donation of equity capital. If the risks inherent in the pipeline venture had been borne directly by creditors and external suppliers of equity capital, the required equity capital would have been a large instead of a small share of the total capital. It is far from certain that such amounts of risk capital would have been available from private sources or that the pipeline could have been constructed on the basis of this mode of financing.

Because of the financial interdependence between ARCO Pipe Line and Atlantic Richfield, the cost of capital employed by ARCO Pipe Line in the TAPS venture is the composite cost of capital to the parent, subject to consideration of whatever may be the risk difference as between the transportation and other functional levels of the integrated operation. The cost of capital to Atlantic Richfield reflects the composite risk of all business activities in which it is engaged. It reflects all sources of risk present in the

physically and functionally integrated business. Investors in an integrated or diversified firm evaluate the composite investment risks associated with the company's stocks and bonds. Those evaluations determine the cost of capital to the firm.

These finance principles may be restated in a different context. The existing capital structure of ARCO Pipe Line reflects financial decisions by the management of Atlantic Richfield, not market appraisals of the risk characteristics of the TAPS venture. The extraordinary use of debt was made possible, not by relative absence of business risk, but by agreements which reduced the risk to bondholders of the pipeline subsidiary at the expense of the parent company's stockholders and bondholders. The financial risk to the owners of Atlantic Richfield is increased by granting the pipeline bondholders a prior claim on earnings. The capacity of Atlantic Richfield to finance other investments with debt capital was correspondingly reduced. Thus, because of the substantial financial interdependence, the opportunity cost of capital and reasonableness of an equity return, cannot be determined by reference to the capital structure of ARCO Pipe Line.

The degree to which these principles have been disregarded by the protestants is exemplified by the computations submitted by Dr. Ileo. He asserts that the purpose of his preliminary report "is to determine, given data which are currently available, tariffs for the pipeline services provided by the major owners of TAPS which will yield a fair return on each owner's equity investment in TAPS." In the case of ARCO Pipe Line, Dr. Ileo adopts 8.05 percent as the annual cost of long-term debt (78.85 percent of total capital), 4.59 percent for short-term debt (14.80 percent of total capital), and cost rates varying from 11 to 15 percent for common equity (9.35 percent of total capital). The

weighted cost of total capital, as thus calculated, varies from 7.82 to 8.19 percent depending upon the choice of equity cost rates.

These cost rates and returns on total capital, tentatively recommended by Dr. Ileo, are below the estimated 8.8 percent average cost of debt to the carriers.[1]

Similarly, the Department of Justice calculated per barrel rates ranging from $3.74 to $4.88, assuming equity ratios of 10, 15 and 20 percent, assuming a 14 percent return on these equity components of total capital and using interest and other costs reported by the carriers (pp. 3-5). A rate of return which might have a reasonable relationship with a broad equity should not be applied to an extraordinary thin equity of 10, 15 or 20 percent. In other words, the protestants made the false assumption that equity investment risk and cost of risk taking do not vary with capital structure leverage and make the results of the invalid calculations the basis of their assertions that the carriers would realize excessive profits. They have disregarded the financial risk normally associated with extraordinary capital structure leverage but borne by the parent in the case of ARCO Pipe Line.

Financial risk is the risk incurred by creditors, preferred stockholders, and common stockholders as the result of a decision by management to issue various types of securities to appeal to investors with different investment preferences. The total risk of the business is thus distributed unequally among the several classes of investors.

Risk to the creditor is always substantially less than risk to the owner of the company's common stock. It follows that the cost of debt capital is always much lower than the

1. Bureau of Investigations and Enforcement, page 20, fn. 29. Dr. Ileo assumes ARCO Pipe Line's annual cost rate for "long-term" debt to be 8.05 percent (Ileo, Schedule 7B), but the terms to maturity are much shorter than for bonds issued by other carriers.

prospective equity income needed to enable the company to sell common stock. Assuming other variables to be constant, higher yields are required by bondholders as the debt ratio rises, the proportion of gross income absorbed by debt requirements increases, and the margin of protection afforded bondholders is reduced. Security is afforded bondholders by the protective covenants of indentures, so that a portion of the business risks inherent in the employment of debt capital is shifted to the stockholders, who also demand higher returns as the debt ratio and the embedded cost rate rise. Since creditors have a prior claim on earnings and assets, the financial risk borne by equity owners increases as the equity ratio declines. They expect and require higher rates of earnings on equity capital as compensation for the greater financial risks associated with the leverage created by the use of senior capital. Therefore, the greater the amount of senior capital and the smaller the ratio of common stock to total capital, the higher the cost of common stock capital. Common stockholders may be willing to accept a larger chance of loss, but only in return for prospectively higher earnings.[1]

1. The conventional finance theory is stated as follows by John F. Childs:

> ". . . as more debt is added, the rating falls, risk is added and interest cost goes up. Since the added debt pushes the equity securities further out on a limb, their quality declines and an even greater return on them will be required by investors." (*Long-Term Financing*, John F. Childs, Prentice-Hall, Inc., 1961, p. 17.)

Dr. Ileo recognized in the following testimony that financial risk, and presumably cost of equity capital, is greater for a firm with a 50 percent debt ratio than for a firm with a 15 percent debt ratio.

> ". . . two unregulated competitors of comparable size, product line, and operation are likely to have the same business risk. I would also argue that they have essentially the same financial risk if one had a 15 percent debt ratio while the other company had a 20 percent debt ratio. If the ratios were 15 and 50 percent, respectively, then financial risk to the latter firm would be greater since it employs considerably more debt." (Union Gas Limited, Ontario Energy Board, C.B.R.O. 343, March 2, 1976.)

Various tests may be applied to determine whether the rates of return proposed by the protestants are consistent with the opportunity cost standard. Among these tests are coverage of interest charges, the ratio of earnings to prices of stocks traded in the market, other evidence of equity capitalization rates, and earnings on book equity (and on total capital) realized by companies generally comparable with Atlantic Richfield. Returns on capital which would be provided by the interim rates proposed by protestants meet none of these tests.

In the case of ARCO Pipe Line, after tax coverage of interest charges at the interim rates proposed by the Department of Justice would be 1.38 times, 1.28 times or 1.19 times, depending upon whether the computations are made on the basis of a 20, 15 or 10 percent equity ratio (Exhibit 1, Schedule II). The submission by Dr. Ileo also indicates an interest coverage of 1.19 times on the basis of the proposed 14 percent return on an equity amounting to only 9.35 percent of total capital.

Actually experienced after-tax interest coverage varies widely, depending upon differences in capital structure, level of interest rates, profitability of operations and other factors. The average for all manufacturers is at least four times. For Class I railroads, a financially instable industry, with a debt ratio of 40 percent, coverage of interest requirements declined from 3.0 times in 1974 to 2.1 times in 1975.

From the viewpoint of creditors, the coverage ratio measures the margin of protection afforded by total earnings and is a principal test of relative safety and quality of a bond. Interest coverage at the level required by the inden-

ture, often two times requirements, is the minimum coverage fixed by contract to protect existing bondholders against unacceptable dilution of investment value. Earnings of two or more times interest charges may be regarded as adequate for a company in a stable industry.[1]

It is evident that without the guarantee by Atlantic Richfield and the shift of risk to its owners, the ARCO Pipe Line bonds could not have been sold on the basis of the prospective interest coverage which would have been provided on the basis of the interim tariffs proposed by the Department of Justice and the State of Alaska.

A conventional rate of return on book equity, such as the 14 percent used by the Department of Justice, should be applied to the kind of equity ratio to which it is rationally related, not to the thin equity which exists in the special circumstances of ARCO Pipe Line. The ratios of common equity to total permanent book capital at the end of 1976 were 75.6 percent for all manufacturers, 81.0 percent for the petroleum and coal industry and 75.6 percent for Atlantic Richfield.[2] The probability of differences of opinion as to whether, in the case of ARCO Pipe Line, a return of 14 percent is reasonably related to a consolidated book equity in the range of 75 to 81 percent suggests the complexity of the issues presented for the Commission's consideration.

The complexity of the issues is also evident from the assertion by the State of Alaska that: "The pipelines are blatantly asking that they be paid twice for the return on that portion of the investment in the carrier property which was provided by debt capital: first in the form of interest expenses and second in the form of a 'return on investment' calculated against the total cost of the carrier property, which includes debt as well as equity securities" (p. 30).

1. *Financial Handbook,* Jules I. Bogan, 4th edition, Ronald, 7-4.

2. FTC, Quarterly Financial Report, 4th Quarter, 1976; Annual Report to Stockholders Atlantic Richfield.

The characterization of the carriers filings as "double-dipping" tends to obscure the relevant issues and makes no contribution to rational, objective analysis. ARCO Pipe Line contends that its filing is consistent with the formula traditionally applied by the Interstate Commerce Commission in determining just and reasonable pipeline rates, specifically a return of 7 percent on valuation with interest expense treated as an "above-the-line" item. A return of 7 percent is below the debt capital cost rate. The issue is whether the return in dollars provided by 7 percent on total valuation (total capital) is equal to the cost of the debt component plus a reasonable return on the equity component of total capital. A fair return, consistent with relevant economic criteria, is the same dollar amount whether the rate base be original cost of plant and property or a valuation which takes account of the impact of experienced inflation. Similarly, a return is the same dollar amount whether it be calculated by applying a single rate to the valuation or by looking to a weighted cost of debt and equity capital.

The protestants urged the Commission to suspend ARCO Pipe Line's tariff and, in order to permit the transportation to commence, allow substantially lower rates to be filed on short notice. These proposals rest upon the premise that the rate proposed by ARCO Pipe Line is *prima facie* unreasonable. I conclude that the protestants have not shown this premise to be valid. If the tariffs proposed by the protestants were to be made effective, ARCO Pipe Line's operating income would be substantially below the cost of capital employed. Therefore, rates filed by ARCO Pipe Line should be allowed to become effective, subject to the remedies provided by the Interstate Commerce Commission, if the rates are found by the Commission to be in excess of just and reasonable rates.

Protest Reply of ARCO Pipe Line.

VERIFICATION

DISTRICT OF COLUMBIA }
CITY OF WASHINGTON } ss:

J. Rhoads Foster being duly sworn, deposes and says that he has read the foregoing statement and knows the contents thereof, and that the same are true as stated.

J. RHOADS FOSTER

Subscribed and sworn to before me
this 22nd day of June, 1977.

PAMELA B. NOELL
Notary Public, District of Columbia
My Commission Expires April 30,
1982.

Protest Reply of ARCO Pipe Line.

BEFORE THE
INTERSTATE COMMERCE COMMISSION
DOCKET NO. 36611
TRANS ALASKA PIPELINE SYSTEM

VERIFIED STATEMENT OF JOHN A. JETER
REGARDING RETURN ON EQUITY

My name is John A. Jeter. I am a certified public accountant and, since 1954, have been associated with Arthur Andersen & Co., a firm of independent public accountants. I am presently a partner in that firm and am in charge of the firm's audit practice in Omaha, Nebraska.

At the request of counsel for ARCO Pipe Line Company (ARCO Pipe Line), I have computed the rate of return on equity invested in the Trans Alaska Pipeline System (TAPS) based on the assumption that revenues and expenses (other than interest and income taxes) would not be changed but the capitalization would include 36.4% debt rather than the actual outstanding debt of ARCO Pipeline. The 36.4% debt is based on information supplied to me showing the consolidated capitalization of the Atlantic Richfield Company (which owns 100% of the common stock, and has unconditionally guaranteed all of the debt, of ARCO Pipe Line) as of December 31, 1976, adjusted to add $265 million of 5.90% Valdez Revenue Bonds issued in the first quarter of 1977 and to deduct $25 million of 7% Notes due March 6, 1978, which were paid during the same period. The information supplied to me also indicates that the outstanding debt included in this Atlantic Richfield Company capitalization has a weighted average cost of approximately 7.5% annually.

For illustrative purposes this computation of rate of return was made using the anticipated revenues available for interest, income taxes, and net income included in the 1978 Initial Tariff-Income Summary (Schedule 1 of Appen-

dix A) for ARCO Pipe Line with respect to its investment in TAPS. The amounts are as follows (in millions):

Anticipated revenues available for —	
Interest	$139.0
Income Taxes	124.6
Net Income	113.6
Total	$377.2

The ARCO Pipe Line valuation estimated for TAPS for 1978 (from Schedule 8 of Appendix A) financed with 36.4% debt is as follows:

Total ICC Valuation	$1,957.9
Less-Debt (36.4% of the average ARCO Pipe Line Net Book Value of TAPS facilities)	681.5
Equity	$1,276.4

The following analysis shows the result of computing the rate of return for 1978 assuming the anticipated revenue level but adjusting the interest, income taxes, and net income to the amounts which would result with the above capital structure:

Recomputed Net Income —	
Revenues for interest, income taxes, and net income *(see above)*	$ 377.2
Interest at 7.5% on Debt above	51.1
Income before income taxes	326.1
Income Taxes at 52.32%*	170.6
Net Income, as recomputed	155.5
Rate of Return on Equity	12.2%

* Based upon an effective state income tax rate of 8.3% and a federal statutory rate of 48% (after deduction of state income taxes of 8.3%), and assuming full inter-period income tax allocation.

In order to facilitate comparisons the rate of return on the average book value of equity was computed in the same manner. That rate is 13.1% for 1978; and the weighted average for the period from September 1, 1977 to December 31, 1981 is 15.2%. Also, using the same method of calculation, the weighted average rate of return on the equity portion of ICC valuation for the period from September 1, 1977, to December 31, 1981, is 13.4%.

VERIFICATION

District of Columbia) ss:

John A. Jeter, being duly sworn, deposes and says that he has read the foregoing statement, knows the contents thereof, and that the same are true as stated.

JOHN A. JETER

Subscribed and sworn to before me
this 22nd day of June, 1977.

SHIRLEY C. PURVIS

Notary Public
of the District of Columbia

My commission expires: April 14, 1980

Protest Reply of ARCO Pipe Line.

[Omitted (reproduced in Volume 3)]

Protest Reply of Union Alaska Pipeline Company, June 22, 1977.

[Caption Omitted in Printing]

BEFORE THE

INTERSTATE COMMERCE COMMISSION

DOCKET NO.

TRANS ALASKA PIPELINE SYSTEM

Reply of Union Alaska Pipeline Company to protest of the State of Alaska; U. S. Department of Justice; Bureau of Investigations and Enforcement, Interstate Commerce Commission; and Arctic Slope Regional Corporation seeking suspension and investigation of initial rates and tariff provisions for the transportation of crude petroleum via Trans Alaska Pipeline System (TAPS) carriers from Prudhoe Bay, Alaska to Valdez Terminal, Valdez, Alaska, as published effective June 20, 30, and July 1, 1977.

INTRODUCTION

In this reply, Union Alaska Pipeline Company ("Union Alaska") will respond to the various allegations and contentions raised by the four protestants. It will do so collectively, to the extent possible, inasmuch as the four protests reflect, in many respects, similar arguments. Where separate contentions have been made, they will be answered individually.

It is the position of Union Alaska that its rate of $6.09 (ICC No. 2) and the rules set forth in its rules tariff (ICC No. 1) are lawful in all respects, consistent with governing standards, and fair and equitable to all concerned. Union Alaska has no objection, however, to the institution of an investigation as to these matters, and, while it is doubtful that the Commission can compel a refund provision as to

initial rates, Union Alaska is prepared, should the Commission deem it desirable, to publish on short notice a refund provision including the payment of interest at no more than that required of carriers subject to Section 15(8)(e) of the Interstate Commerce Act.

BACKGROUND OF UNION ALASKA PIPELINE COMPANY AND ITS PARTICIPATION IN TAPS

In late 1968 Union Oil Company of California ("Union Oil") became a participant in the Trans Alaska Pipeline System. That was during the engineering and cost estimating phase of the project, then described as a 600,000 B/D system with expansion possibilities to a 2,000,000 B/D system. At that time, Union Oil's participation was at a 3.25 percent level. Shortly thereafter, one of the owners dropped out of the project and Union Oil's interest was increased to 3.32 percent. Subsequently, a decision was made (effective July 15, 1974) to build, essentially concurrently with the 600,000 B/D facility, the additional facilities for a 1,200,000 B/D system. Union Oil elected not to participate in the system expansion and consequently its participation level dropped to 1.66 percent, where it now stands.

Prior to construction beginning, the Union Oil Company's interest in TAPS was transferred (effective January 8, 1974) to a newly created company, entitled Union Alaska Pipeline Company, incorporated in the State of California and wholly owned by Union Oil.

A. Uniqueness of Union Alaska Pipeline

At the time of taking an interest in TAPS, Union Oil had the primary expectation of realizing a reasonable rate of return on its pipeline investment in light of existing Con-

sent Decree standards. In addition, Union Oil had hopes of realizing oil production on the North Slope of Alaska by approximately the time the pipeline became operable. However, Union Oil is *not* a crude oil producer on the North Slope and this single fact makes Union Alaska's situation unique when compared to all other owners in TAPS. Moreover, it is a fact ignored by all of the protestants who are in a position to know the truth. Indeed, the protestants have blanketed Union Alaska in with all of the producers. Union Alaska's entire investment in TAPS must be supported by revenue largely from unaffiliated shippers on its pipeline capacity, and its rate has been kept to the lowest possible minimum to attract such traffic. Two other TAPS owners, Mobil and Amerada Hess, do have pipeline capacities significantly in excess of their respective crude production rates, giving their situations some similarity to that of Union Alaska. This fact is also ignored by protestants.

B. Cost Escalation

Frequent reference is made by protestants to the fact that the original cost estimate for TAPS was greatly exceeded with the completed cost being in excess of 9.0 billion dollars, and from this flow assertions of inefficient management. The difference between the original cost estimate and final cost is accounted for by many factors, most of which can be attributable to the actions of certain of the protestants and other interests. Some of the principal factors were (a) very demanding and costly environmental stipulations; (b) lower labor productivity than previously estimated, because of severe climatic conditions; (c) the long delay in being granted the construction permit, which pushed construction into the recent double digit inflationary period; and (d) much higher labor rates than had been expected.

With regard to assertions of improvidence or inefficiency on the part of protestants, particularly by the State of Alaska, both the Supreme Court and this Commission place a heavy burden on those making such allegations. The Court stated in *West Ohio Gas Co.* v. *Ohio Pub. Utility Comm'n.*, 294 U.S. 63, 73 (1935):

> "Good faith is to be presumed on the part of managers of a business. . . . In the absence of a showing of inefficiency or improvidence, a court will not substitute its judgment for theirs as a measure of a prudent outlay."

To the same effect, see *Hanna Mining Co.* v. *Missouri Pacific R. Co.*, 332 I.C.C. 166, 171 (1968). The melange of assertions by Mr. Lenzner, many of which rely on owner quotations taken out of context, have been structured so as to reach a preconceived result. No credit is given to the fact that this gigantic project was successfuly completed in a timely manner in the face of the heaviest of obstacles both natural and man-made. The one-sided presentation of protestants affords no basis for a restructuring of the rate level at the suspension stage.

Nor does it afford a basis for the unbridled discovery sought by the Bureau of Investigations and Enforcement in flat violation of the form and procedure required by the Commission's Rules of Practice. Discovery requests should properly be made before the presiding administrative law judge where appropriate justification therefore can be made. They have no place at the suspension level. See Special Rule of Practice 200, 49 CFR § 1100.200. Stated in another way, there is a proper way to go about such discovery. Failure to do so can result in judicial restraint. See *Union Oil Co. of Calif.* v. *FPC*, 542 F.2d 1036 (9th Cir. 1976). In a similar vein, requests of the Commission staff and those

functioning on their behalf for data or information must be made on the record. See *Davis & Randall, Inc.* v. *United States*, 219 F. Supp. 673 (W.D. N.Y. 1963); *Home Box Office, Inc.* v. *F.C.C.*, No. 75-1280 (D.C. Cir., March 25, 1977).

CONTENTIONS OF PROTESTANTS AND REPLIES THERETO

1. Valuation Methodology

In varying degree, the State of Alaska, the Department of Justice, and the Arctic Slope Regional Corporation attack the methodology used by this Commission in establishing rates based on the valuation of the property owned and used by the joint owners. Indeed, the State of Alaska opposes the use of the Commission's valuation as a rate base.

Protestants' quarrel is basically twofold: their first and most obvious concern is with Section 19a(i) of the Interstate Commerce Act which accords a carrier's final valuation prima facie weight as evidence of the value of the property in all proceedings under the Act. An evaluation of initial rates in the suspension phase of Section 15(7) is hardly the proper framework in which to pass upon the continuing validity of a statute. Congress is the more appropriate forum. However, when Congress enacted the provisions of the Railroad Revitalization and Regulatory Reform Act of 1976, pipelines, which along with railroads are Part I carriers, were specifically excluded from the scope of the new statute. As stated by the House Committee on Interstate and Foreign Commerce:

> "The Committee has not included oil pipelines in it (i.e., the new standards of rate making), since there

does not, at the present time, appear to be a need to do so. Under Part I of the Interstate Commerce Act, the tariff rates of interstate common carrier oil pipelines are subject to ICC regulation to the same extent as those of railroads. Historically, in determining the reasonableness of the rates of an oil pipeline, the ICC has based such determination upon the annual valuation of the pipeline established by the Commission. Included in the formula used by the Commission in establishing annual valuations of pipeline companies is a factor reflecting the reproduction cost-new of the pipeline system, less depreciation. The use by the ICC of the annual valuation of the pipeline in determining the reasonableness of its rates has permitted the industry to generate common carrier revenues and earnings adequate to engender substantial capital investment in, and needed expansion of, the nation's pipeline network."[1]

Second, to the extent that protestants' concerns relate to valuation methodology, as distinct from the use and merits of Section 19a, this Commission has already indicated that pending Docket Ex Parte 308 is the appropriate proceeding in which to consider such matters, and the State of Alaska and the Department of Justice have filed statements therein. Moreover, by Supplemental Order served December 16, 1975, in Ex Parte 308, the Commission determined, in effect, that that proceeding looks to issues for prospective effect and that existing valuation, accounting, and property reporting requirements should continue to govern pending proceedings.

What protestants advocate here at the suspension level, where the proceedings are informal (see 49 CFR

1. H.R. Report No. 93-1381, 93rd Cong., 2d Sess. P. 26, n.1 (1974).

§ 1100.200(a)) and where a protest is prohibited from being considered a formal complaint (49 CFR § 1100.42(a)), is that the statutory scheme be replaced with what effectively constitutes a rule-making proceeding of their own invention. There is no warrant in law for such an approach. See *N.L.R.B.* v. *Wyman-Gordon Company,* 394 U.S. 759, 764-766 (1969); *Wagner Electric Corp.* v. *Volpe,* 466 F. 2d 1914 (3rd Cir. 1972); *North American Van Lines Inc.* v. *United States* 412 F. Supp. 782 (N.D. Ill. 1976); *A. E. Staley Mfg. Co.* v. *United States,* 310 F. Supp. 485 (N.D. Minn. 1970); *Chicago, Burlington & O.R. Co.* v. *United States,* 242 F. Supp. 414 (N.D. Ill. 1965), aff'd per curiam, 382 U.S. 422 (1966).

At the very least, protestants' advocacy of a new and unprecedented standard in I.C.C. regulation carries with it a heavy burden of making a convincing showing that the established standards are unreasonable. See *Nader* v. *Federal Communications Commission,* 520 F. 2d 182, 192 (D. C. Cir. 1975). Protestants have completely failed in this burden. Union Alaska and those who have invested in it were and are entitled to rely upon the pattern of regulation in the pipeline industry as set forth in the Consent Decree and consistent Commission precedent. See *Secretary of Agriculture* v. *United States,* 346 U.S. 645, 653-654, (1954).

2. Rate of Return on Shareholders' Equity as a Standard For Pipeline Ratemaking

Much of our preceding views relative to the impropriety of discarding valuation has application to protestants' contention that rate of return on equity should be applied as a standard. Initially, it should be stated that such a test has never been applied to oil pipelines, including Williams Pipe

Line in Docket Nos. 35533 et al., and pending I. & S. Docket No. 9089. Moreover, such a test is absurd on its face since almost all of the TAPS carriers are Consent Decree carriers, and thus are barred by court order from paying more than 7 percent in dividends to their equity owners. Quite obviously, the return on equity concept is designed to measure payments to shareowning interests to determine if they will gain an inordinately high return. Yet, the Consent Decree bars payments over 7 percent, a test in effect for over 36 years which has never been modified notwithstanding the vast changes in industry generally and oil pipelines in particular.

It must also be emphasized that the Department of Justice is as equally bound by the Consent Decree as are the companies involved, and that agency's advocacy here of a different and conflicting concept constitutes, at the very least, a collateral attack on the Decree.

The Consent Decree is a most pervasive form of economic regulation, and effectively subsumes into it, by its very nature, any asserted violations as to Sections 1, 2, 3(1) and the National Transportation Policy. Probably no other regulated industry has remained under such a restraint, judicial or otherwise, for so long a time. The Consent Decree limitation is a firm and unwavering limitation unlike the 8 percent and 10 percent "benchmarks" against which crude and product pipeline rates, respectively, have been measured. These "benchmarks" are *not* prescribed standards. In actual practice, they have been merely guidelines by which the rates of pipelines have been measured, along with other considerations, and found lawful; they are themselves the subject of re-evaluation in Ex Parte No. 308.

As to Union Alaska, return on equity is a meaningless and inapplicable calculation in any event in view of the

company's capitalization. On April 30, 1977, Union Alaska's balance sheet showed the following liabilities:

	Million Dollars
Short term notes	118.1
Accounts payable	0.8
Notes payable to Union Oil Company	2.5
Capital stock	5.0
Unappropriated surplus	1.8
	128.2

Since that date, Union Alaska has reached verbal agreement for the private placement of $83.125 million in 8.30 percent long term promissory notes. The notes, as well as Union Alaska's short term obligations, are fully guaranteed by Union Oil. The investors required this parent company's support and corresponding liability for its shareholders due to the financial uncertainties associated with the TAPS project.

Union Alaska has not computed a "cost of equity" and does not believe that such a computation would be meaningful for the following reasons. The tariff rate Union Alaska proposes to charge its customers is determined by the maximum dividend allowable under the Consent Decree. That calculation requires no determination of "cost of equity." Since Union Alaska is a wholly-owned subsidiary of Union Oil, any such computation would be meaningless in any event. In addition, the business reasons for Union Oil's participation in the TAPS project simply had nothing to do with the cost of equity. The financing pattern and allowable tariff had been effectively established by the Consent Decree precedent with which Union Oil and Union Alaska and others must live. Under these rules, the expected tariff was thought to be reasonable in the circumstances and Union Oil joined the project.

3. Twenty-Five Year Life Versus Thirty-Five Year Life

It is variously asserted that something higher than a 25 year life should have been utilized. The Arctic Slope Regional Commission asserts a useful TAPS life of 35 years. The Bureau of Investigations and Enforcement relies on the van Poollen Study and asserts that it describes a range of oil recovery lives of 25 to 30 years. Such a conclusion represents a misstatement of that study's contents. In fact, it describes case lives ranging from 17.25 to 28.75 years and implicitly supports the 25 years relied upon by the carriers. A 25 year life is also consistent with the independent De Golyer and MacNaughton Study prepared for the owners. All such studies properly relate to maximizing oil recovery of known existing recoverable reserves. While other potentially recoverable reserves may exist, they must be considered a contingency at best; they hardly constitute a firm and reliable basis upon which to deprive the carriers of wholly needed revenue.

The original 25-year projected economic life of the Cook Inlet Pipeline in Alaska is a good example of a pipeline life falling short of the 35 year life normally used for trunk lines that serve many producing fields. As with the Cook Inlet Pipeline, TAPS is a pipeline serving a single or local area of production. Union Alaska management is entitled and, indeed, required to rely on known existing recoverable reserves and not on speculation since to establish rates based upon such contingencies adds to the burden of risk assumed by the investors. In fact, if this risk is to be so increased, a higher overall rate of return may well be justified.

It must also be recognized that the additional reserves described by the protestants may be uneconomical to recover, *not* because of the rates charged by the carriers but because of any of a number of geologic, economic, political,

social or environmental reasons. Failure to take such factors into account indicates the patent narrowness of protestants' contention. The physical life of the line must be viewed conservatively because of its extreme length and the climatic conditions affecting it.

4. Risk

An element of risk is present in any new venture. All of the protestants, and particularly the State of Alaska, contend that the question of risk does not exist. Such postures suggest their lack of real-world familiarity with the subject. Nevertheless, a consideration of all risks from the time of inception of TAPS indicates that they are, and will continue to be substantial. Among the prior risks were the following:

1. The TAPS line constituted a great private undertaking with severe climatic, mechanical, and environmental problems. There was no absolute assurance that it could be done, or, that it would operate as designed.
2. Inflation.
3. Changing governmental regulation.
4. Environmental considerations.
5. Delays in construction.

Among the present risks to be faced are:

1. If substantial discoveries of oil, breakthroughs in technology in oil shale, nuclear or solar energy, or a breakdown in the world oil pricing mechanism, etc., occur, the most costly, inaccessible and least desirable sources of crude production would de-

cline. The Alaskan North Slope crude production would undoubtedly be reduced in such a situation, thus lowering line throughput.

2. The line is vulnerable to attack or sabotage by anyone ranging from an enemy to a blackmailer.

3. Environmental damage through a break in the line or other causes may result in extensive damage claims.

4. Reports indicate there will be a surplus of crude oil on the West Coast once the line is fully active. If permission to ship Alaskan crude to foreign countries or to trans-ship the West Coast crude to the Gulf is hampered, a reduction in Alaskan crude production would probably result, lowering the line throughput.

5. New environmental rules that make high sulphur Alaskan oil less desirable.

6. The risk of state and federal regulatory changes.

7. Changes in taxation, some of which have already been discussed in the Alaska legislature.

8. Labor: strikes, lack of productivity, excess in wage demands, etc., in the pipeline itself or in the oil fields, in terminaling, shipping, or refineries.

9. Geologic risks, such as the field failing to live up to performance expectations.

To ignore these factors, as protestants have done, is to obscure the realities facing the pipeline owners.

5. Taxes

It is asserted by protestants that the use of tax normalization should be disallowed. The net effect of such an approach would be to subsidize present-day shippers to the detriment of those who may later come on line. The virtues of normalization have again been recognized in the recent decision of the United States Court of Appeals for the District of Columbia Circuit in *The Second National Natural Gas Rate Cases,* No. 76-2000, decided June 16, 1977, (D.C. Cir.). In this far-reaching decision with its wide-ranging implications for a Nation "engaged in a searching review of its entire energy policy and a possibly restructuring of agency powers" (slip opinion at p. 93), the court both rejected as "simplistic" the interpretation that only "actual taxes paid" can govern (slip opinion at p. 38) and indicated that if any policy change were required, a "combination of the higher probability that substantial taxes will be paid and the likelihood that there will not be acquiescence in indefinite deferral of tax revenue" would support such a change (slip opinion at p. 39).

Union Alaska clearly fits within these concepts. It computed book depreciation, using a 25 year life which was determined on the basis of the best information available. Union Alaska is both a wholly-owned subsidiary of the Union Oil and is a member of the consolidated group which files a federal income tax return. Union Oil has elected Asset Depreciation Range ("ADR"), as provided under Internal Revenue Code Section 167 and regulations thereunder and as provided in Rev. Proc. 77-10, permitting the taxpayer to select depreciable lives which, for pipeline transportation properties, range from 17.5 years to 26.5 years. Union Oil and its affiliates have adopted a policy of using the lowest ADR life in computing depreciation

under the ADR election. In conjunction with the ADR election, Union Oil has adopted the double-declining balance method, with a switch to the sum-of-the-years-digits method for purposes of computing allowable depreciation.

The foregoing method of computing depreciation creates a larger deduction for tax depreciation than book depreciation during approximately the first twelve years of the pipeline life. This larger depreciation deduction, in turn, reduces the amount of federal income tax currently applicable to Union Alaska compared with the amount of income tax that would be payable if straightline depreciation had been adopted. Thus, in order for Union Alaska to properly take into account its income tax for rate-making purposes, it is compelled to adopt "deferred tax" accounting (i.e., "normalizing"). If the tax expense for rate-making purposes were not normalized through deferred tax accounting, the federal income tax expense would be lower in approximately the first twelve years and greater in the remaining years. The effect of this would cause current rate payers to pay lesser tariffs than future rate payers because of the tax benefits of greater depreciation in the earlier years. Another effect of flowing through the tax benefits of accelerated depreciation is that the pipeline company is effectively precluded from adding accelerated funds to its working capital as intended clearly by Congress.

In summary, normalization accords fully with the intent of Congress with respect to the use of accelerated depreciation and investment tax credit; is in accord with rulings of the American Institute of Certified Public Accountants; ensures that substantial taxes will be paid in the foreseeable future; and is consistent with the rational of *The Second National Natural Gas Rate Cases, supra,* this Commission's approach in *Petroleum Products, Williams Brothers Pipe Line Company,* ICC , served December 21, 1976, slip opinion at p. 14, citing *Memphis Light*

Gas & Water Div. v. *Federal Power Com'n.,* 500 F.2d 798 (D.C. Cir. 1974),[1] and the thoroughgoing treatment of this subject in the submission of the Association of Oil Pipe Lines in Ex Parte 308. No different treatment is warranted here at the suspension level.

6. Restoration Costs

Alyeska has estimated a cost of $1,049 million for dismantling the line and restoring the environment. This is expressed in terms of 1977 dollars. If inflation increases at an annual rate of 6 percent, for example, dismantling the restoration costs will be $4,490 million at the end of 25 years.

The State of Alaska says that the $.10/bbl included in the tariff to cover the restoration cost (which is simply 1/25th of $1,049 million per year divided by 1.2 million bbls/day) is too high because it ignores the earning capacity of the removal fund and is based upon a 25 year rather than a 35 year pipeline life. The logic and merits of the 25 year life have been discussed above. The fact is that the earning capacity of the removal fund must be retained in order to compensate for the effects of inflation over the life of the project. Otherwise, the line would have $1,049 million on hand at the end of 25 years to pay for a $4,490 million expense—assuming 6 percent inflation.

7. Interest Expense

The question of the recovery of interest expense reflects perhaps the most egregious example of protestants' misunderstanding of real-world economics. In Union Alaska's view, interest expense must be considered as an allowable

1. As of its 1976 Form P Annual Report, Williams Pipe Line's average effective tax rate had risen to 44.8%, thus underscoring the accuracy of the Commission's approach.

expense to be recovered in the tariff rate. The investment economics of TAPS, or any other common carrier pipeline, under the 7 percent earnings limitation of the Consent Decree, are based on, and require the recovery of interest as an allowable expense.

Within the context of a 7 percent limitation on dividend payments, the argument presented by the protestants that either interest expense be excluded from the tariff rate or an allowable return be established only on the equity portion of the investment *completely ignores the fact that the debt-supported portion of the investment must also generate a return or such an investment would not be attractive.* It must be emphasized that such debt is a very real liability of the shareholders, rather than a carrier liability as would be the case if carrier assets, for example, were pledged against the debt. Therefore, the shareholders are entitled to the full dividend based on 7 percent of valuation, net of any interest payments.

The Justice Department has proposed that TAPS tariffs be set on the basis of a 14 percent return on equity which again offers no return on valuation (and investment) supported by debt. If such a return were appropriate on 14 percent equity, for example, would it not, by the same argument, be appropriate on 100 percent equity? In this latter case, a tariff level of about $7.50/bbl would be required. We doubt that this is what they have in mind.

The subject of interest expense for Consent Decree carriers has never been conclusively resolved by this Commission. In the *Williams* decision of Division 2, *Petroleum Products, Williams Brothers Pipe Line Co.,* 351 I.C.C. 102, 136 (1975), the placement of interest "below the line" was apparently the result of the decision by Williams, an independent carrier, to state its case in the most conservative manner possible. On the other hand, in reporting to Con-

gress on the carriers' average return on investment for companies owning oil pipelines, the Commission gave effect to interest. See "Regulations of Various Federal Regulatory Agencies and Their Effect on Small Business," Hearings before the Subcommittee on Activities of Regulatory Agencies of the Committee on Small Business, House of Representatives, Ninety-Fourth Congress, First Session, Los Angeles, California, August 29; Washington, D.C., October 2 and November 12, 1975, pp. 873, et seq., as corrected by letter of Chairman Stafford to Subcommittee Chairman Hungate, dated March 22, 1975. In addition, in Docket No. 36352, *Petroleum Crude Oil, Griffith, Ind. to N.Y. State Points,* initial decision served November 15, 1976, which became final by operation of law by notice served December 15, 1976, the increased rate there at issue was found lawful with interest as an item of expense.

There is most assertedly no unfair recovery in the approach taken by Union Alaska. The interest computed is discretely and separately stated. *The failure to permit the recovery of so substantial an item of expense could only result in one of the sharpest disincentives to investment by private capital in meeting the Nation's energy supply emergency.* Whatever doubts may exist in this regard should properly be resolved in favor of a pragmatic adjustment to remove any possible severe and unwarranted constraints. See *The Second National Natural Gas Rate Cases, supra,* at slip opinion, p. 92.

BOTH THE LAW AND THE EQUITIES FAVOR THE APPROACH RECOMMENDED BY UNION ALASKA

As indicated heretofore, Union Alaska has no objection to an investigation of the rates at issue subject to the publication on short notice of a refund provision with interest at no

higher than that currently required of other carriers subject to Section 15(8)(e) of the Act. Union Alaska believes that that Section provides an analogous and current expression of Congressional direction. The provision provides for refunding of increased rates found not justified with interest at a rate equal to the average yield (on the date the rate schedule was filed) of marketable securities of the United States which have a duration of 90 days. While that provision applies only to railroads and only to increased rates, Union Alaska is prepared to accept it in this proceeding. In Union Alaska's view, such an approach is eminently fair and protects all present or reasonably prospective shippers in a manner not inconsistent with law. Moreover, in contrast to protestants' demands for various rate prescriptions at various lesser levels at this time and on this informal record, Union Alaska's approach prevents the loss forever of revenue to which it believes it is entitled as a matter of law, economics, and fair and even-handed treatment.

Protestants, on the other hand, seek what flatly constitutes a rate prescription at this time and in a context where much of their allegations are variously conjectural, lacking in specificity, unsworn, and not subject to cross-examination. There is no instance where this Commission has ever adopted such an approach as to initial rates. Where the Commission has suspended rates without prejudice to a republication at some lesser level or subject to the utilization of funds for a special purpose, such action occurred only in general revenue-need proceedings where changes in rates were involved, where a waiver of Commission tariff publishing regulations were sought, where the Commission had previously established by formal order the type and form of supporting data required, where shippers had no recourse to judicial review without exhausting their administrative remedy through the filing of a complaint, and where the order fashioned conformed to the carriers' own supporting evidence.

No such situation exists here. The rates at issue are initial rates. The publishing carriers have a statutory right to have the protestants meet their burden of proof at a hearing on the record. Ignoring that right by a rate prescription at the suspension stage of the case would unlawfully deprive them of due process and constitute an unlawful taking of their property. See *Moss* v. *C.A.B.*, 430 F.2d 891 (D.C. Cir. 1970).

It must also be recognized that there is no presumption of wrong arising from either a change of rate or an initial rate of a carrier. As stated by the late Commissioner Freas, as to the publishing of rates ". . . the presumption of honest intent and right conduct attends the actions of carriers." Freas, "Ratemaking Powers of the ICC," 31 George Washington Law Review 54, 67 (1962). Commissioner Freas recognized that "comparison of the suspension procedure with that of a restraint proceeding in a court of equity emphasizes that both are discretionary and extraordinary remedies." *Id.* at 68. No extraordinary factors exist to warrant the exercise of that remedy here in the manner urged by protestants. No prima facie errors are shown on the part of the carriers, or Union Alaska in particular. Conversely, a firm basis has been demonstrated in law and fact for the use of the statutory tax rate; interest has been properly computed and allocated; the Consent Decree's mandates have been complied with; a reasonable foundation for the 25-year life has been shown; the removal costs are properly stated; risk is substantial; and present and reasonably foreseeable shippers can be protected in a manner not inconsistent with law.

Protest Reply of Union Alaska.

To the extent that the Commission may wish to inquire further into the protestants' allegations, it may properly do so via a full hearing and on a formal record. To attempt to fit the carriers and Union Alaska in particular to protestants' Procrustean bed is unlawful, discourages the investment of private capital, and is inimical to the Nation's best energy and economic interests.

WHEREFORE, Union Alaska Pipeline Company respectfully requests that the proposed tariff be allowed to become effective subject to investigation and the publication of a conditional refund provision by each carrier, such provision to include interest at a rate consistent with Section 15(8)(e) of the Act.

Respectfully submitted,

GEORGE C. BOND,
General Counsel

SAM A. SNYDER,
Assistant General Counsel

DONALD P. KRAINESS,
Assistant Counsel

Union Oil Company of
California
Union Oil Center
Box 7600
Los Angeles, California,
90051
(213) 486-7600

Protest Reply of Union Alaska.

DAVID M. SCHWARTZ
SULLIVAN & WORCESTER
1025 Connecticut Avenue,
N.W.
Suite 500
Washington, D.C. 20036
(202) 293-6170

Attorneys for Union Alaska
Pipeline Company

[Certificate of Service Omitted]

Second Supplement to Protest Petition and Complaint by Arctic Slope Regional Corporation, June 23, 1977.

BEFORE THE INTERSTATE COMMERCE COMMISSION

[Caption Omitted]

SECOND SUPPLEMENT TO PETITION AND COMPLAINT BY ARCTIC SLOPE REGIONAL CORPORATION FOR SUSPENSION OF INITIAL RATES AND RULES FOR TRANSPORTATION OF PETROLEUM VIA THE TRANS ALASKA PIPELINE SYSTEM (TAPS) FROM PRUDHOE BAY, ALASKA, TO VALDEZ, ALASKA, AND FOR AN INVESTIGATION THEREOF

In its statement of justification to the Commission, Sohio explained the basis for its rate tariffs. Set forth in Attachment A is ASRC's supporting data for its proposed $3.00 reduction in Sohio's tariffs, which amount should be used in reduction of all other proposed TAPS tariffs in the absence of evidence indicating that such other rates are supported by considerations other than those advanced by Sohio.

In Column A there is listed the Sohio data which is the basis for a $6.16 pb rate. Column B sets forth ASRC's adjustments to the Sohio data, which indicate that a $3.00 reduction is necessary. In Column C, ASRC's proposed 15% reduction in capitalized costs and capital is not included as it is in Column B calculations, and the resulting rate is $3.69 pb. Recent news reports indicate that there is the likelihood of an oil glut on the West Coast, but that TAPS oil may be swapped with Japan and other countries in exchange for East Coast crude oil deliveries. In this event, TAPS throughput may quickly reach 2.0MMbpd, and the calculations in Column D support a rate tariff under those circumstances of $2.28 per barrel.

Supplement to Protest by Arctic Slope.

The assumptions propounded by the TAPS carriers as reflected in the Sohio data which is analyzed in the attachment hereto prima facie are improper. The unreasonably high rates should be suspended, therefore, because they are unreasonable, and also because of their anticompetitive effect on oil exploration in the Arctic North Slope, in contravention of the National Transportation Policy and antitrust laws. Accordingly, the Commission should order suspension and an investigation, granting special permission to file and make effective on one day's notice rates which are $3.00 less than those initially issued, pending conclusion of a suspension and investigation proceeding.

Respectfully submitted,

ARCTIC SLOPE REGIONAL CORPORATION

By O. YALE LEWIS, JR.
CHARLES A. GOLDMARK

500 Maynard Building
Seattle, Washington 98104
(206) 622-9603

Of Counsel:

WICKWIRE, LEWIS, GOLDMARK, DYSTEL & SCHORR
500 Maynard Building
Seattle, Washington 98104

BECKER AND FELDMAN
1819 H Street, N.W.
Suite 950
Washington, D.C. 20006

By WILLIAM W. BECKER
JAY T. FRENCH

1819 H Street, N.W.—Suite 950
Washington, D.C. 20006
(202) 293-1919
Its Attorneys

Supplement to Protest by Arctic Slope.

JUSTIFICATION FOR ARCTIC SLOPE REGIONAL CORPORATION 13.0¢pb REDUCTION IN PROPOSED TAPS RATE TARIFFS USING SOHIO PIPE LINE COMPANY DATA

Line		A. SOHIO DATA AND COMPUTATION 1/ (1466MB per year) Total ($000,000)	¢pb	B. SOHIO CAPITALIZED COST, INTEREST, USEFUL LIFE OF TAPS, AND IMPUTED TAXES AS ADJUSTED BY ASRC (1466MB per year) Total ($000,000)	¢pb	Dif. A & B ¢pb
1	Operating Revenue Lines 7+9+10	899.4	616	461.4	316	(300)
	Operating Expenses					
2	Ad Valorem Taxes	51.0	35	51.0	35	(0)
3	Interest	252.5	173	185.6 6/ 7/	134	(39)
4	Removal & Restoration	14.0	10	10.0 8/	7	(3)
5	Depreciation	126.2	86	76.2 9/	52	(34)
6	Other	84.2	58	84.2	58	(0)
7	TOTAL	527.9	362	417.0	286	(76)
8	Net Operating Revenue before Taxes	371.5	254	44.4	30	(224)
9	Imputed Income Taxes	196.5 2/	135	12.9 10/	9	(126)
10	Net Income After Tax	175.0	119	31.5	21	(98)
11	Valuation	3315.0		2667.7 11/		
12	TAPS Capitalized Costs	3138.5		2667.7 12/		
13	Equity	444.0		377.4 6/		
14	Debt	2707.5		2301.4 6/		
15	Total Capital Lines 13+14	3151.5		2670.8 6/		
16	Return on Equity 3/	39.4%		8.3%		
17	Return on Total Capital 4/	13.6%		8.3%		
18	Return on Valuation 5/	12.9%		8.3%		

NOTE: Columns may not add because of rounding.

Supplement to Protest by Arctic Slope.

Notes

1. Source for all data: Sohio letter dated June 13, 1977, and Schedules attached, unless otherwise indicated.

2. Sohio uses statutory rate of 52.9% rather than the flow through method which allows for consideration of the effect of accelerated depreciation and investment tax credit.

3. Line 10 ÷ Line 13.

4. (Line 10 + Line 3) ÷ Line 14. Note, that Sohio does not include interest as a return on valuation.

5. (Line 10 + Line 3) ÷ Line 11. See note 4 above.

6. Capitalized costs of $3138.5 million, Equity of $444 million and Debt of $2,707.5 million reduced by 15% because of the TAPS overrun caused by Alyeska mismanagement. See, Protest/Complaint, State of Alaska, pp. 6-11; ASRC Petition and Complaint, pp. 10-11.

7. Interest at 9.3% reduced to 8.5% based upon Sohio Cost of Borrowed Funds—see, Attachment A-1.

8. ASRC calculates Removal and Restoration Cost as amortized over 35 years. $1,049 billion ÷ 35 = $.02997 billion. $29.97 million × .3334 = $9.99 million per year, or 6.8¢ pb, a 29% reduction. See, Protest/Complaint, State of Alaska, pp. 45-51, and ASRC Petition and Complaint, p. 15.

9. ASRC calculates Depreciation Expense on the basis of a useful life of 35 years. Depreciation equals capitalized cost divided by 35 and, as a non-cash deduction, constitutes a return on capital over 35 years and a source of working capital.

10. In using a statutory tax rate of 52.9%, Sohio fails to account for the 10% investment tax credit by which it benefits. According to the Mortada Study (FEA) (Nov. 1976), p. IV-19, the effective tax rate is reduced to .476 as a result of the tax credit.

Further, Sohio computes its taxes as if depreciation for tax purposes were deducted on a straight-line basis. If, to the contrary, depreciation is deducted on the basis of 200% of declining balance, depreciation deductions in the early years of TAPS operation will reduce federal income taxes substantially. Taxes will be reduced further by substantial investment tax credits of 10% of the cost of the pipeline, or approximately $313.9 million. This credit may be used, up to 50% of Sohio's tax liability, to offset not only TAPS income but also other income of Sohio on a consolidated return. SEC Form S-1, filed by the British Petroleum Company Limited on June 14, 1977, Registration No. 2-59269, states that net income taxes for 1976 were $56 million on $192.9 million of net income, which amounts to an imputed rate of 29%. Page F-39. It further is stated

that $36 million of the $56 million in taxes were deferred, resulting in an effective and actual tax rate of 10.4 percent. Page F-45. These figures support ASRC's position that the statutory tax deduction proposed by Sohio is unwarranted for purposes of computing returns on valuation and capital and that the "flow through" method should be used in this rate-making proceeding.

Using a 10.4% imputed rate and all of Sohio's other data, net income for 1978 would be $332.9 million, resulting in a return on equity of 75%, a return on Total Capital of 18.6%, and Net Income as a Percentage of Valuation of 10%. These returns on invested capital are unparalelled in American industry and the Commission should not countenance them at the expense of ASRC and the American consuming public.

For purposes of ASRC's adjustments, an imputed tax rate of 29% is used, although a substantially lower rate may be warranted.

11. ASRC proposes that principles previously used by the ICC in the calculation of valuation are inappropriate for TAPS and that cost of reproduction new, as a basis for valuation, not be applied. This is particularly so where Sohio and the other TAPS carriers claim that the pipeline must be removed after 25 years and seek to amortize removal expenses over that period. Working capital allowance also is eliminated on grounds that non-cash deductions, such as depreciation, will provide sufficient working capital. The method of valuation proposed by Sohio and other TAPS carriers (1) fails to recognize the time value of investment recovered through depreciation and return on equity, (2) improperly double charges the rate payer by the use of a 6% additive for "going concern" value, (3) provides for a windfall recovery by equity owners not only on the basis of their own investment but also on the basis of the amount of debt for which compensation is provided in the charging of interest, and (4) fails to account for the TAPS carrier claims that the pipeline must be removed after 25 years. ASRC proposes valuation based upon actual investment.

12. Column D assumes transportation of 2.0 million barrels per day, of which Sohio's .3334 interest equals 243.38 million barrels per year, and otherwise uses the same adjustments as Column C.

13. Operating expense increased by estimated 20% for additional throughput of .8MMbpd.

ATTACHMENT A-1

COMPUTATION OF SOHIO COST OF BORROWED CAPITAL

At page F-49 of Form S-1, filed with the SEC by The British Petroleum Company, Limited, on June 14, 1977, Registration No. 2-59269, the long-term debt of Sohio is listed. The list follows, to which is added a column listing the annual interest payable (or estimated payable):

	December 31, 1976	Annual Interest
	(Thousands of Dollars)	
Guaranteed notes—10⅝% ($39,254 due in 1980, $78,509 annually 1981-1992, $46,220 in 1993, $35,161 annually 1994-1997, $8,104 in 1998)	$1,176,330	$124,985.1
Guaranteed notes—9¾% ($11,176 due in 1980, $22,353 annually 1981-1992, $9,403 in 1993, $4,971 annually 1994-1997, $1,147 in 1998)	309,846	30,210.0
Guaranteed note—8⅝% (due in 1983)	169,500	14,619.4
Guaranteed note—9¼% ($1,695 due annually 1980-1984, $8,475 annually 1985-1998, $42,375 in 1999)	169,500	16,526.3
Notes—6⅛% (due in 1979)	75,000	4,593.8
Notes—6½% (due in 1981)	75,000	4,875.0
Notes—7½% (due in 1986)	200,000	15,000.0
Notes—7.1% (due in 1977)	200,000	14,200.0
Notes—7.6% (due in 1979)	50,000	3,800.0
Notes—8% (due in 1981)	75,000	6,000.0
Debentures—8¼% ($7,750 due in 1986, $15,500 annually 1987-2000, $25,250 in 2001)	250,000	21,875.0
Debentures—8½% ($6,300 due annually 1981-1999, $30,300 in 2000)	150,000	12,750.0
Debentures—7.6% ($4,200 due annually 1980-1998, $20,200 in 1999)	100,000	7,600.0
Sinking fund debentures—4¼% ($1,250 due annually 1978-1981, $997 in 1982)	5,997	254.9
Notes payable to banks—variable interest rate—6¼% at year-end ($15,000 due annually 1978-1980, $7,500 in 1981)	52,500	3,281.3

Supplement to Protest by Arctic Slope.

	December 31, 1976	Annual Interest
	(Thousands of Dollars)	
Promissory notes—4.55% ($2,000 due annually 1978-1989, $10,000 in 1990)	34,000	1,547.0
Revolving credit notes—variable interest rate—6.9% at year-end	100,000	6,900.0
Revolving credit notes—variable interest rate—6⅞% at year-end	100,000	6,875.0
Promissory notes (4.6% to 5.8% at year-end) Assume average at 5.2%	212,716	11,061.2
Payables incurred by agent (Alyeska Pipeline Service Company) for construction of trans-Alaska pipeline	79,000	
Industrial revenue bonds—5⅜% to 5⅞% (due annually in varying amounts, 1986-1998) Assume average 5.7375%	37,900	2,174.5
Other Assume 8.5%	4,558	387.4
	$3,626,847	$309,515.9

On the basis of the above data, Sohio's average interest rate, or cost of borrowed capital, at year end is approximately 8.5%.

[Certificate of Service Omitted]

Reply of Sohio Pipe Line Co. To Protests, June 22, 1977.

BEFORE THE INTERSTATE COMMERCE COMMISSION

[Caption Omitted in Printing]

REPLY OF SOHIO PIPE LINE COMPANY TO THE PROTESTS AND PETITIONS FOR SUSPENSION OF ITS INITIAL TARIFF, I.C.C. NO. 742, SUPPLEMENT NO. 1, FOR THE TRANSPORTATION OF PETROLEUM FROM PRUDHOE BAY, ALASKA TO VALDEZ, ALASKA VIA THE TRANSALASKA PIPELINE SYSTEM

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BEFORE THE
INTERSTATE COMMERCE COMMISSION
I.C.C. Docket No. 36611

TransAlaska Pipeline System—Initial Rates

REPLY OF SOHIO PIPE LINE COMPANY TO THE PROTESTS AND PETITIONS FOR SUSPENSION OF ITS INITIAL TARIFF, I.C.C. NO. 742, SUPPLEMENT NO. 1, FOR THE TRANSPORTATION OF PETROLEUM FROM PRUDHOE BAY, ALASKA TO VALDEZ, ALASKA VIA THE TRANSALASKA PIPELINE SYSTEM

This is a reply to each of the protests and petitions for suspension which have been filed with respect to Sohio Pipe Line Company's initial tariff, I.C.C. No. 742, Supplement No. 1.[1] Each of the protests are based upon the erroneous premise that the Commission's decision whether to suspend initial rates pending investigation of their reasonableness requires the resolution of hotly contested issues of fact and theories of regulation. In addition, the Department of Justice appears to be under the erroneous impression that the burden of proof is on the carriers to establish the reasonableness of the initial rates on pain of suspension. The Department in fact suggests (pages 8-9 of its Protest and Petition) that the terms of the statute (49 U.S.C. § 15(7)) and the decisions of the Supreme Court of the United States provide that if the proposed rate is challenged before it goes into effect, that the carriers must

1. The specific protests and petitions to which this reply is addressed are those of the State of Alaska; the Department of Justice, Antitrust Division; the Bureau of Investigation and Enforcement of the Interstate Commerce Commission; and the Arctic Slope Regional Corporation.

"establish that the rate meets statutory standards." Of course neither the statute nor any decision of the Supreme Court of the United States provides any such thing. At this stage of the proceedings before the Interstate Commerce Commission the justness and reasonableness of the rates are not at issue except as the matter must be prima facie considered to determine whether petitioners have shown that an investigation is required. The attempt to divert the Commission into consideration now of difficult, complex and hotly contested issues as to valuation, alleged mismanagement of the project, fair rate of return and theories or regulation simply avoids arguing the real questions now before the Commission. The Commission cannot now, and certainly is not supposed to, decide whether the proposed rates are reasonable as it would have decided if it enforces lower rates pending investigation. Rather, the question is, if it appears that the initial rates may, after hearing turn out to have been too high and thus an investigation by the Commission is required, are there substantial interests which would be irreparably injured by permitting the filed rates to go in effect without suspension which outweigh the certain irreparable injury that suspension would impose on the pipeline carriers should it turn out, after investigation and hearing, that the filed rates are just and reasonable and conform to the Act. In *United States* v. *Chesapeake & O. Ry. Co.*, 426 U.S. 500 (1976) the court said (page 513), addressing the power of suspension given the Commission in § 15(7), that "Its purpose was to protect the public from the irreparable harm resulting in unjustified increases in transportation costs. . . ." The court cited with approval (footnote 10) the statement in S. Rep. No. 94-499 p. 13 (1975) that the suspension power is to protect the public interest because while shippers can

secure a refund consumers have no such remedy. We submit that the need for suspension to avoid irreparable injury is the only question appropriately addressed in this proceeding at this stage.

Neither the State of Alaska nor the shippers nor the Arctic Slope Regional Corporation nor the consuming public will be irreparably injured by permitting the rates to go into effect as filed on the specified dates. Suspension of the rates with the consequent suspension of service would impose massive economic injury on all the parties to this action and to the general public. Forcing lower rates pending the investigation by the threat of imposing such massive injury through suspension would gain nothing for the petitioners or the public that they cannot obtain without it.

Petitioners would have the Commission, like some bureaucratic godfather, make the pipeline companies an offer they cannot refuse. We submit that it would be morally wrong and plainly illegal for the Commission to embark on any such enterprise no matter what circumlocution it may be clothed in.

1. The Sole Question Before The Commission Is A Balancing Of Equities Pending Further Investigation.

The Commission's rules of practice respecting proceedings relative to suspension (49 CFR § 1100.200) provide that they shall be informal, that no transcription will be made, that subpoenas will not be issued and oaths will not be administered. Yet the petitioners would have the Commission consider, at this preliminary stage, issues both of fact and law that are extremely complex.

The TransAlaska Pipeline System (TAPS) was a project of unprecedented difficulty and complexity. Massive in-

vestigations relating principally to the cost of the project are in progress by the State of Alaska, the Staff of the Interstate Commerce Commission, and the General Accounting Office. They give promise of continuing for an extended period. We gather that these agencies believe they have to date only scratched the surface. We are met here with accusations of mismanagement and waste and sweeping conclusions of fact based upon an admittedly partial investigation. We are presented with hundreds of pages of out-of-context quotations and paraphrases from construction files. Any attempt to make a meaningful response on the merits of these accusations would bog down this proceeding in a morass of issues not yet ripe for decision and which, in any event, must be based upon facts which are unknown and, in the time frame involved, unknowable.

Only the full time to develop the relevant facts will answer the questions being asked by petitioners. Indeed, a piecemeal picture cannot display the difficult construction decisions that had to be made on a continuing basis during the largest private construction project in history under exceedingly difficult conditions, which is perhaps the perspective from which the questions raised must be viewed.

The other contentions of the protestants have to do with the theory of regulation and include such questions as what is an appropriate rate of return, whether the rate base should be determined by present commission practice or by some other method and how taxes shall be reflected. These matters are the subject of extensive testimonial filings and arguments in *Ex Parte 308* which has been pending for some time and hearings in which are now set to begin on August 16 of this year. These are questions which this Commission believed should not be decided in a specific litigated case even after a full hearing because of their

novelty, their applicability to all pipelines and because of the pendancy of *Ex Parte 308. Petroleum Products, Williams Brothers Pipe Line Company,* Docket No. 35533, Division 2, 351 I.C.C. 102 (1975) and full Commission pp. 6-8 (December 3, 1976). Yet these protestants would have this Commission decide these questions now or perhaps, more accurately, decide this proceeding as if *Ex Parte 308* and any investigation of these rates (which the Commission may well order) had already come out as they, apparently, wish. It is plain that the coercion of a rate much lower than that filed, as demanded by petitioners, would be, in fact, a final decision. The suggestion that the Commission should deal with these massive economic issues in so cavalier a fashion without evidence and without hearing, impugns the integrity of the decisional process of this Commission.

This power of the Commission to suspend takes the place of the power theretofore existing in the district courts of the United States to enjoin rates claimed to be unlawful and improper (*Arrow Transportation Company* v. *Southern Ry.*, 372 U.S. 658 (1963)). The question before this Commission therefore is not dissimilar to that before a United States District Judge in determining whether to issue a preliminary injunction.

In *Atchison, T. & S.F. Ry.* v. *Wichita Board of Trade,* 412 U.S. 800 (1973), the Court, giving consideration to the factors which should govern a reviewing court in determining whether to enjoin an order of the Commission pending decision, stated as follows (pages 823-24):

> In addition, the reviewing court must consider whether irreparable harm will result if the injunction is not issued and the party seeking it prevails on the merits. *Order of Conductors* v. *Pitney, supra.*

> That too many interfere with the agency's primary jurisdiction. We deal here with a dispute between shippers and carriers. In giving the Interstate Commerce Commission power to suspend proposed rate increases, Congress allocated the benefit and harm of suspension. For a period of up to seven months, the carriers may not collect the increases if the Commission suspends them. The income that they might have gained is lost to them forever. Congress did provide protection to shippers for the period after the rates go into effect. The Commission may require carriers to keep detailed accounts of the income received as a result of the increase. If the increase is ultimately found unjustified, the Commission may order a refund. 49 U.S.C. § 15(7). Even if the Commission does not do so in a suspension proceeding, the shippers may recover reparations under some circumstances. 40 U.S.C. §§ 8, 9. Thus, it is often quite unlikely that shippers will be irreparably damaged by the implementation of a rate increase.

In *Samson* v. *Murry,* 415 U.S. 61 (1974), the Court held that a district court has no power to grant an injunction without a showing of irreparable injury pointing out that (page 88):

> . . . the record before us indicates that no witnesses were heard on the issue of irreparable injury, that respondent's complaint was not verified, and that the affidavit she submitted to the district court did not touch in any way upon considerations relevant to irreparable injury.

Here no attempt has been made by the petitioners to address the question of *irreparable* injury.

2. No Irreparable Economic Injury Will Result To Petitioners Or To Consumers From Permitting The Rate To Go Into Effect Without Suspension.

Central to the consideration of the merits of suspension is the specific economic effect at this time of the TAPS tariff. We do not think it is disputed that the applicable Federal ceiling price of oil at the wellhead (over $11.00 per barrel) is such that the wellhead value in the case of Prudhoe Bay, Alaska is determined by the competitive world price of oil in the lower 48 states which is now approximately $13.50 per barrel. Transportation costs, including tanker costs, would have to be substantially less than $3.00 per barrel for the ceiling price to have any effect. Thus, the market price of the oil will be fixed by competition and will not be affected by the tariff level. The value of the oil at the wellhead at Prudhoe Bay is the "netback" from the sale price of the oil at destination—*i.e.*, the price at destination minus the cost of getting it there. See affidavit of T.C. Roth attached hereto. Thus, the level of the pipeline tariff has a direct effect on the wellhead value of oil at Prudhoe Bay but no effect whatsoever on the price of oil to refineries or the price of petroleum products to the public.

This is simply a contest among the state, primarily as a proprietor, and a few oil pipelines and producers as to how the sale price of the oil shall be divided up and incident to that, the return on the risks undertaken to finance, build, operate and maintain the first large diameter pipeline of its kind. In another sense it is a contest as to what contribution the State of Alaska shall make in its proprietary capacity to the cost of getting the oil to market. If the tariffs are allowed to go into effect pending examination

of the questions raised by petitioners and the Commission shall later find any of the rates to have been too high, indicated economic inbalances including those of the State's interests, can be retroactively adjusted through Sections 8 and 9 of the Interstate Commerce Act or by the Commission (or even by agreement). If, as the petitioners demand, the Commission imposes a lower rate pending its investigation and hearings, any resulting error cannot be remedied. It will have made, in fact, a final determination. The case is exactly like that outlined in the quotation from *Atchison, T. & S. F. Ry.* v. *Witchita Board of Trade, supra,* set out at page 5 above. Thus, the equities between the parties require that the rates become effective as filed and we submit there are no "public interest" considerations requiring a different treatment.

Ordinarily rates and practices involved in proceedings before a regulatory tribunal affect the price which the public will pay for the commodity or service involved either directly or indirectly through its incorporation in other articles or services provided to the public. This is usually the public interest which the tribunal considering suspension or a court considering an application for temporary injunction, must weigh against the possible irreparable injury to the carrier. Shippers may recover for their damage under §§ 8 and 9 of the Interstate Commerce Act, but ordinarily customers of the shippers and others down the distribution line from there who, perhaps, pay higher prices because of the increased cost of shipment may not. See *Southern Pacific Co.* v. *Darnell-Taenzer Lumber Co.*, 245 U.S. 531 (1918). This is not because the statute forbids it. The statute says (49 U.S.C. § 8) that in case any carrier shall do anything prohibited by the Interstate Commerce Act, the carrier shall, in language very like § 4 of the Clay-

ton Act (15 U.S.C. § 15), be liable "to the person or persons injured thereby" for the damages sustained. Rather, it is because of the practical problems of proof and the virtually impossible litigation management problem that would be presented thereby. *Southern Pacific Co.* v. *Darnell-Taenzer Lumber Co., supra. Illinois Brick Co.* v. *State of Illinois,* 45 L.W. 4611 (U.S. Sup. Ct. No. 76-404, June 9, 1977).

The level of the pipeline tariff has a direct effect, dollar for dollar, on the wellhead value of the oil and no other direct effect. This is not distinguishable from the situation of the customer of a shipper with a cost plus contract. See *Illinois Brick Co., supra,* at 4615 and note 16. *Cf. Arrow Transportation Co.* v. *Southern Ry.,* 372 U.S. 658, 669 (1963) suggesting that a competitor damaged by too low a rate may have a cause of action under § 8 of the Act.

The amount and placement of the economic effect of a change in the tariff depends upon the interrelationship of the affected parties and the differences in interest are not clearcut. The State of Alaska owns (as royalty owner) 12½ percent of all the oil.[2] Thus, it pays the tariff either as a shipper or through the effect of the tariff on the sale price of oil at the well.

The other interests are (a) the private shippers of oil and (b) the pipelines. If a shipper of oil ships all of its oil over a wholly owned subsidiary pipeline and it is the sole shipper, then it should theoretically be indifferent to the tariff except as it may impact on its severance tax. Operating under this theoretical assumption the Arctic Slope Regional Corporation suggests that the carriers and their affiliated producers will merely shift back and forth among themselves any gain or loss resulting from tariff adjustment. However, the situation is not that simple. Sohio Petroleum Company is entitled to about 53 percent of the production of the field but its affiliate, Sohio Pipe Line Company, owns 33 percent of the pipeline. There is no way The Standard Oil Company could profit from a high tariff.[3] BP Pipelines and Union Alaska own pipeline but their parents own no oil. There are others who own oil but no pipeline. Moreover, for these and other reasons, the owner of oil which has a pipeline subsidiary will not necessarily ship over it. However, no matter what the economic relationships, they can clearly be retroactively readjusted should the tariff be readjusted under the provisions of the Interstate Commerce Act.[4]

We submit that there simply is and can be *no irreparable* injury to any presently perceived economic interest if upon consideration, after the investigation and hearings to be held, the Commission should determine that the pipeline tariffs, or any of them, should be lower than those now on file.

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2. It also is interested, through its 12¼ percent severance tax, in the wellhead value of the other ⅞ of the oil. However, it has imposed a "floor" on the tax of $.80 per barrel which is equivalent to its percentage tax on a $6.53 wellhead value. Thus, its initial loss in severance tax, if any, is mitigated and in any event such loss, if there be any, if not recoverable under the statute (§8) is subject to state laws relative to recovery of back taxes—a matter within Alaska's control.

3. It has a major interest, however, in allocating costs where they belong and in insuring that investors will, in the future, supply the money to build high-risk pipelines to transport oil discovered in places difficult of access.

4. The Arctic Slope Regional Corporation shows that the present value of its entitlement to a large sum to be paid by the State of Alaska out of the latter's oil royalties would be diminished by any stretch out of such payments caused by an unreasonably high tariff. This shows an 8½ percent decrease over 14 years from a $1 increase in tariff. This is only six tenths of one percent per year and we deal here with a rate pending further decision. In any event even if such "damages" were too remote for direct recovery under the Act, the Regional Corporation would automatically receive their share of any augmenting of the royalty fund recovered by the State.

3. Petitioners Have Not Sustained The Burden Of Showing That There Are Any Interests Which Require The Suspension Of The Tariffs.

The Department of Justice asserts that "the Supreme Court has interpreted § 15(7) to mean that when a proposed rate is challenged before it goes into effect, the carrier must establish that the rate meets statutory standards." The erroneous impression held by the Department of Justice may perhaps explain why it dealt almost entirely with questions to be decided by the Commission not in this informal hearing but after hearing the evidence and making findings on the merits after hearing.

So far as we can ascertain there is no decision of any court which has anything to say about the burden of proof on a petition to suspend. The only reference to burden of proof in § 15(7) of the Act is in the next to last sentence thereof which provides:

> At any hearing involving a *change* . . . the burden of proof shall be upon the carrier to show that the proposed [change] . . . is just and reasonable. (emphasis added).

This proceeding, of course, does not involve any change. Indeed, even the brief of the State of Alaska, which is not notable for the restraint with which it makes claims or interprets the statutes and cases, points out that the burden of proof language of the statute refers only to a change in rate as distinguished from an initial rate. (page 18) The Bureau of Investigation also correctly treats burden of proof (pp. 34-35). We suppose we need not belabor this point because the distinction in the burden of proof between an initial rate and a change in rate is well settled in the

practice of this Commission. We note that in its "Summary of Pipeline Regulatory Provisions and Procedures of Interests With Respect To Initial Tariffs Of The Trans-Alaska Pipeline System" issued by this Commission's Office of Proceedings and Section of Rates, dated April 18, 1977, it is stated:

> When initial rates are involved, those challenging the rates have the burden of proof. *Rail-Water, Grain in Bulk, Mo. Ill., and Ind. to Buffalo,* 321 I.C.C. 564 (1963).

The cases cited in footnote 13, page 9, of the Government's brief simply do not hold what the brief says they hold.

In *Atchison, T. & S.F. Ry.* v. *United States,* 279 U.S. 768, 773 (1929), the Court said:

> Since the proposed tariff involved an increase in the rate, the burden of justifying the increase before the Commission was imposed upon the carrier by paragraph 7 of Section 15, if applicable.

In that case the Santa Fe filed an increase which was initially suspended by the Commission and then extensive hearings were held and the increase was denied. The Santa Fe had made no attempt to justify the increase as an increase in rates claiming that on certain technical grounds the Commission had no power to deny the increase.

The quotation from *Atchison, T. & S.F. Ry. Co.* v. *Wichita Board of Trade,* 412 U.S. 800, 814 (1973), set out by the Justice Department at the top of page 9 of its brief is grossly misleading. In the first place, the matter quoted on page 814 is not a holding of the Court, but is a part of an analysis by Justice Marshall of the statutory framework within which the Commission was constrained in determin-

ing the reasonableness of rates. The case involved a rate change and it involved a review of the Commission's decision made after full hearing not upon a petition for suspension. As Justice Marshall noted at the beginning of his opinion, the Supreme Court had noted probable jurisdiction to resolve two important questions relating to the proper role of the courts in reviewing approval by the Interstate Commerce Commission of "proposed rate increases by railroads." One of the important considerations in the case was whether the Commission should fully try out the justness and reasonableness of the proposed increase in the proceeding involving the proposed increase or could remit claims regarding specific rates to suits by shippers for reparations. At page 812 it was noted that in a reparations proceeding "the shipper must show that the rate charged was unreasonable." And then stated at page 813 "In contrast, when a proposed rate increase is challenged by a shipper before it goes into affect, 'the burden of proof shall be upon the carrier to show that the proposed changed rate . . . is just and reasonable.' 49 U.S.C. § 15(7)." Thus, Mr. Justice Marshall clearly read the statute the same way the Commission reads it. Moreover, this all refers to the burden of proof in proceedings to determine the reasonableness of a rate—not proceedings to decide whether there shall be suspension pending such a hearing.

As we have noted above, the briefs of the Department of Justice, the State of Alaska and the Bureau of Investigation and Enforcement are devoted almost entirely to the merits of the reasonableness of the rates submitted, a question which surely this Commission must decide after hearing the evidence from both sides as distinguished from the aggressive overstatements of counsel. While petitioners devote much time to a discussion of their view of the merits,

they give little time to the real issue before this Commission which is whether the public interest requires that these rates be suspended pending a determination of the merits.

Of course, in any matter involving an appeal to a tribunal for an interlocutory injunction or suspension pending a determination of the merits of a claim, at least a preliminary determination must be made of the likelihood that petitioners will succeed on the merits. This does not, of itself, warrant the issuance of an injunction or a suspension because otherwise it would simply be a prejudgment of the merits. One gains the impression that this is exactly what the petitioners seek. Quite clearly, however, in order to warrant the suspension the petitioners must show harm to the interests represented by them which outweighs the heavy damage that would be visited upon the pipeline companies in the event the decision, here to be made by the Commission on 3 days' notice and without hearing the evidence, turns out to be erroneous.

We have shown above that neither petitioners nor consumers can be irreparably injured by permitting the tariffs to become effective pending review. However, the Department of Justice alludes in part VI at page 7 of its brief to a claim that "unreasonably high transportation rates restrict output and prevent the realization of cost savings derived from the large economies of scale associated with pipelines." It suggests that unreasonably high transportation rates discourage exploration and development of new fields by reducing the wellhead value of crude oil and thereby decreasing returns on production. They suggest that rates such as those proposed here would unnecessarily impair incentives to exploration for new sources of crude oil.

The State of Alaska, at pages 22 and 23 of its brief, makes the same point. It surely is true that the minimization of return will discourage exploration for new sources

of oil and it surely is also true, that the imposition of unreasonable financial burdens on the exploitation of new discoveries will discourage such search and exploitation. The claims that this truism warrants the imposition of the heavy economic loss implicit in suspending (pending determination of reasonable rates) the initial rates of the TAPS pipeline carriers or imposing lower rates defies reply because it is not supported by analysis.

The position of the State of Alaska as a petitioner herein must be understood in terms of its own self interest which it is advocating. It owns one-eighth of all of the oil produced at Prudhoe Bay. In addition, in the years since the discovery at Prudhoe Bay was made, it has imposed a variety of taxes—severance tax, income tax, *ad valorem* taxes—which create an overall tax burden that equals or exceed all other leading oil producing states in the United States today. The results of this tax structure has been projected by the Commissioner of Revenue in Alaska to create a surplus in the state treasury after all bills are paid of 8½ billion dollars by the year 1985. This is more than $23,000 for every man, woman and child resident in the state—three times the per capital income. In addition, during these interim years, the State exacted, through an *ad valorem* tax on oil in the ground, an interest-free advance on severance taxes totaling 500 million dollars to carry it through its deficit period during the last two years. What's more, the State received a few years ago nearly a billion dollars for the mere right to explore for more oil. If the development of the energy resources of the Arctic are restrained, it is not by the cost of transport.

In any event, any restraint on exploration by pipeline rates herein does not threaten irreparable injury in any time period involved here. The consequences of excessive

burdens on explorations and exploitation could be serious but they are long range. Moreover, lest it be thought that absent some interim reduction in transportation charges pending consideration by the Commission whether in fact these charges are unreasonable, the State of Alaska will suffer some temporary deprivation, it should be noted that the State of Alaska will receive from this oil at the tariff proposed by Sohio approximately $900,000,000 (in royalty and tax revenue) in 1978, well over $2400 for each and every one of the 365,000 men, women and children resident in that State.

We submit that it is plain that there has been no showing of any real threat of irreparable injury to the interest of any petitioner or to the public interest as it may be claimed to be represented by the Department of Justice of the United States. We note, however, that its view of the public interest here involved seems rather narrow. To talk in one breath about the national energy policy requirement that there be an inducement to the development of natural resources, particularly energy resources, and at the same time to contend for the practical elimination of any incentive to build and operate a pipeline under the most adverse conditions known to man, strikes us as somewhat inconsistent.

Although we believe that the merits of the tariff level and the factors which control it are not issues before this Commission at this time, the unjustified expressions of outrage and overstatements of fact made by some petitioners require some answer.

4. The Proposed Rates Do Not Reflect Unreasonable Rates of Return.

Most of the pipeline companies involved in this proceeding are restrained by the terms of a consent decree which

prevent the receipt of dividends by the parent companies of the pipeline companies in excess of 7 percent of the I.C.C. valuation and thus implicitly restrict the earnings of the pipeline companies available to stockholders to 7 percent of such valuation. *United States* v. *Atlantic Refining Co.*, 360 U.S. 19 (1959). Entirely apart from any question of reasonableness, this decree is a restriction under which the pipeline companies operate and which these companies must observe in fixing tariffs. As some of the petitioners point out, the constraint of the consent decree has no necessary relationship in 1977 to a reasonable rate for a common carrier pipeline through the Arctic waste of the North American continent. By that decree the Department of Justice agreed that receipt of pipeline earnings by shipper-owners of 7 percent or less of the valuation of the pipeline would not constitute a rebate under the Elkins Act. It is implicit in this agreement that profits not in excess of 7 percent on I.C.C. valuation *prima facie* reflect a rate which is not unreasonable. We submit that for purposes of the consideration of whether the proposed rate is *prima facie* too high, the fact that it comes within the constraints of the consent decree should be dispositive.

The claims of the petitioners all turn about disagreement with the economic results of the consent decree under present conditions and an attempt to convince this Commission that under theories espoused by them, the pipeline companies will receive "exorbitant" returns on their "equity" investment. This is another red herring and simply does not deal with the economic facts of life.

The question whether regulation of the rates of common carrier pipelines, particularly those pipeline companies that are subject to the constraint of the consent decree, should be based upon the earnings of the pipeline companies available to shareholders or whether public utility modes of

regulation which would place any interest cost below the line and deal with total returns available for capital, is a question which presumably will be decided by this Commission in a rulemaking in *Ex Parte 308* or elsewhere. There is much to be said for having rates of pipeline carriers consistent with consent decree standards. The modes of regulation suitable for gas and electric utilities are not necessarily suitable for common carrier oil pipelines, particularly where the preservation of incentives for the exploitation of almost inaccessible resources is, as shown by the Department of Justice, an important facet of national energy policy.

But these are not questions to be decided upon on three days' consideration in a suspension proceeding.

The Association of Oil Pipelines has filed before this Commission in *Ex Parte 308* the sworn testimony of Raymond B. Gary, a Managing Director of Morgan, Stanley and Co., who has wide experience in the actual financing of many enterprises including that of oil companies and in particular the extra-ordinarily difficult and expensive financing which Sohio Pipe Line Company and its parent, The Standard Oil Company, were compelled to undertake to finance its very large share of the TransAlaska Pipeline System. He expresses the opinion, based upon his experience and the careful study outlined in that testimony, that for a low-risk pipeline the return level required by investors under current market conditions would be 13 percent to 14 percent. This is based, incidentally, on a capital structure of 30 percent debt with a 8½ percent debt cost and 70 percent equity at 15 to 16 percent. The cost of debt to Sohio Pipe Line guaranteed by its parent in this case was 9.3 percent. Mr. Gary points out that for a higher debt ratio, in addition to a higher interest rate on debt, a higher cost of equity would have to be included to reflect the

greater concentration of the risk of the enterprise in the equity indicated thereby. In 1978 it is estimated that Sohio Pipe Line Company will earn a profit of approximately 6 percent and a return before interest expense using Mr. Gary's approach of 12.9 percent on valuation under the proposed tariff. Moreover, TAPS is clearly not a low-risk pipeline.

Now the petitioners in this case attempt to paint a kind of horror story of very large returns on equity by referring to the capitalization of the pipeline companies which in this case are all subsidiaries of oil companies. In Dr. Ileo's attachment to the State of Alaska's brief he claims in Schedule 5(c), a percentage of debt for Sohio Pipe Lines of 98.2 percent of capitalization and on page 1 of his statement he says Sohio Pipe Line Company will receive an "estimated profit rate on equity of 264 percent." We suppose that Dr. Ileo presumes to some knowledge of economics though his qualifications are not stated. We think that Dr. Ileo knows full well that in the case of Sohio (and we deal here only with Sohio Pipe Line Co.), it is the wholly owned subsidiary of The Standard Oil Company and that its debt is wholly guaranteed by The Standard Oil Company and that either by guarantee or by advances, its entire capital is provided by The Standard Oil Company. One does not have to be an economist to know that the capital costs for Sohio Pipe Line Company reflect not the perception of investors as to the risks of Sohio Pipe Line Company alone or the TransAlaska Pipeline System alone, but rather that of The Standard Oil Company as a consolidated enterprise including the chemical business, the coal business, the plastics business and the uranium business as well as the oil business. Since the financing costs reflected in the capitalization of Sohio Pipe Line Company for TAPS

reflects the risks of the consolidated business of The Standard Oil Company, not simply TAPS or the pipeline business, to suggest as Dr. Ileo does that the interest costs and other costs of capital so procured by The Standard Oil Company as a consolidated enterprise reflect the investor appraisal of the risks appropriate to determining what is a reasonable return on the value of the TransAlaska Pipeline System at the pipeline companies' capital ratio, is manifestly unfair and does not deal with the real world. To suggest that the rate of TAPS return should be limited to that earned by long-established electric or gas utilities in the populations centers of the lower 48 states, strikes us as being a little bit ridiculous. We submit that in these circumstances the suggestion of Dr. Ileo that Sohio is proposing a return of 264 percent on its investment, or even the modest recanting of this claim by the tabulation at page 37 of the brief of the State of Alaska is, we submit, not worthy of even passing consideration.

In the light of the risks involved, the realities of the financial marketplace and the need to promote the national energy policy by provision of adequate economic incentives to exploit energy resources difficult of access, the profit returns implicit in the suggested pipeline tariffs are plainly *prima facie* reasonable. Clearly they present no basis for the exercise of this Commission's power of suspension, even if the possibility of irreparable injury were shown by the petitioners which it has not been.

5. The Exaggerated Claims Respecting The Rate Base Do Not Warrant Suspension.

The question whether the Commission's long-standing practice as to valuation shall be abandoned in favor of some other method of determining rate base will be

examined in *Ex Parte 308* or elsewhere. Plainly, the results of that on-going rule-making proceeding should not be anticipated or prejudged in this informal proceeding. Similarly, it would be erroneous to anticipate here, the results of a valuation proceeding for TAPS. So we do not pause to argue this point.

The sheer bulk of paper presented by the petitioners in support of the claim that the construction of the pipeline involved waste and inefficiency and that the value should, for this reason, be written down in major degree, defies any rational attempt to deal with these claims or, more specifically the characterization of the significance of the out of context quotations presented. At the same time petitioners complain of their inability to examine vast quantities of material in addition to the thousands of pages already obtained.

It is difficult to know what to say about these claims. In this sort of situation the accuser can—and here certainly does—say what he will knowing that there is no practical way to counteract the charges and hoping to effect an invidious impression. We have here the largest private construction job ever undertaken, initiated and carried through on time, surmounting not alone bureaucractic delays and regulatory burdens probably without parallel but also the harshest climatic conditions ever confronted by a major construction project. Now swarms of accountants, lawyers and management consultants in comfortable offices pour over documents and interrogate employees in a process of second guessing (probably as unequaled in scope as the project itself), not simply to reach some balanced overview as to the efficiency with which these enormous difficulties were overcome and the validity of judgments made under pressure of time and weather, but in an atmosphere of almost vindictive prosecution.

We earnestly hope that we can look to the staff of the Interstate Commerce Commission to conduct its investigation and make its judgments based thereon with even handed regard for all of the interests involved. Good or bad, the investigations are now barely under way. The returns are not in and we submit that this proceeding is not one in which to reach any conclusion with respect to rate base.

6. The Commission Should Not Resolve Accounting Methods In This Proceeding.

Complaint is made as to the 25 year service life used for depreciation. Twenty-five years is the estimated life of the Prudhoe Bay oil field which is the only oil now available for shipment over the line. One may speculate as to whether additional oil will be discovered in areas which the pipeline can service. Certainly these pipeline companies devoutly hope that it will be. We point out, however, that the Commission's uniform system of accounts for pipelines require the application of annual percentage rates which will distribute the service value of the property by the straightline method in equal annual charges to operating expenses during the service life of the property. The service lives are to be estimated by "engineering and other studies." 49 CFR 1204, 1-8. This paragraph makes provision for the revision of the percentage rate for depreciation. Obviously neither the tariffs themselves nor the rates for depreciation are graven in bronze and each will be changed when conditions warrant. Twenty-five years is the best estimate of life at the present time. It is unsound economically, and we think contrary to the uniform system of accounts to extend estimated service by optimistic hopes of future expectations. But here again this is not a matter for decision in a sus-

pension proceeding. Similarly with respect to the treatment of taxes for tariff-making purposes, normalization is fairly standard regulatory practice and was the course of action adopted in the *William Brothers* case. We submit that this problem should not be given attention in this proceeding.

7. The Commission Has No Power To Impose Interim Rates.

All parties to these proceedings recognize that suspension of the rates without more would prohibit the initiation of transportation and would impose enormous and irreparable economic injury on many interests not the least on those of the State of Alaska. Although all of the petitioners nominally ask for the Commission to exercise its power of suspension, none of them want suspension. What they really ask the Commission to do is to impose different and lower rates than those filed by the carriers.

It is crystal clear that the Interstate Commerce Act, 49 U.S.C. § 15(7), gives no power to the Commission to impose a different rate than that proposed by the carriers pending determination of the reasonableness of the proposed rate or change in rates. The only power which the Commission has is to suspend the proposed rates pending a determination as to their reasonableness but for not longer than seven months in any event. This is a different power than the power to make some temporary reduction or change or what is the same thing to suggest that a "voluntary" fixing of some lower rate will be permitted to take effect.

Indeed, if the statute be construed to give the Commission power to impose directly or indirectly some different rate or practice pending its determination of reasonableness, it denies to the carrier the right to have any determination at all as to the reasonableness of its initial filing because the subsequent hearing, if any, would be as to the validity of the interim rate so imposed.

The brief of the Bureau of Investigation and Enforcement points out (at page 35) the obvious fact that suspension of the rates for seven months, or for any other period, "does not merely postpone increases, but rather stops all operations, and hence some rates must be allowed." We point out in passing that this fact differentiates the situation here from a suspension of a proposed change and is so different in kind as to possibly indicate an intention by Congress that the power to suspend an initial filing was not intended. In any event, the Bureau takes the position that because of the drastic consequences of suspension, the Commission may use the pressures of such consequences to impose a different and lower rate than that proposed by the carriers. The Bureau says that the Commission has often permitted the refiling of a lower rate pending the proceeding when proposed rates were ***prima facie*** unreasonable. (But citing an I.C.C. proceeding for this dating prior to the decision of the D.C. Court of Appeals in the *Moss* case and no case where its right to do so was litigated.) Recognizing, however, the problems created by the case of *Moss* v. *CAB*, 430 F.2d 891 (D.C. Cir. 1970), it proposes that the problem be avoided by the Commission makin the statement that it was not fixing rates within the meaning of *Arizona Grocery* v. *Atchison, T. & S.F. Ry.*, 284 U.S. 370 (1932). What a triumph of form over substance! The argument is especially incredible because the court in *Moss* expressly rejected such a formalistic interpretation of *Arizona Grocery*. *Moss* at 895-97. In the *Moss* case, the Civil Aeronautics Board suspended the airlines' filing for an increase in rates and then after discussions with the airlines, advised them that, if they filed new rates conform-

ing to a specified formula, such rate would not be suspended. The Court held that this was rate making and that the hearings and consideration of evidence required for rate making were not observed and thus this was an unlawful exercise of the suspension power. The severe financial pressures on the airlines were an important factor in the Court's analysis:

> As a practical matter, the Board's order amounted to the prescription of rates because, as the Board admits, the pressures on the carriers to file rates conforming exactly with the Board's formula were great, if not actually irresistable. *Moss, supra,* at 897.

The economic compulsion on the carriers (and the State of Alaska as well) to avoid suspension as in *Moss,* means that any Commission suspension order which "suggests" maximum rates will inevitably coerce the pipeline carriers to adopt the Commission rates. The realities of the situation mean that the Commission will have prescribed rates. Under 49 U.S.C. §15(1), the Commission has power to set rates only after a full hearing as to reasonableness. Thus the petitioners are asking the Commission to issue an illegal suspension order.

The Bureau would distinguish the *Moss* case because "unlike *Moss* the Commission here would in no way prejudge the outcome of its investigation of the lower rates." Well, we do not know whether the Commission would prejudge the outcome of its investigation of the lower rates or not. But it surely will have prejudged the outcome of its investigation of the rates actually filed with respect to which it exercised its suspension power. Moreover, this is not an appropriate characterization of *Moss.* In *Continental Airlines, Inc.* v. *CAB,* 522 F.2d 107, 129 (D.C. Cir. 1974), the court viewed the *Moss* case as involving "sham suspensions aimed at coercing behavior rather than merely preserving the status quo pending investigation." The proper path for the Commission in this case will, in many respects, be difficult to discern but it surely will be crystal clear if the Commission adopts the proposal of the petitioners that it will have imposed a sham suspension aimed at coercing behavior rather than merely preserving the status quo pending investigation. This, of course, puts the finger right on the significance of and the purpose of the suspension power. That is to preserve the *status quo,* keep things as they are pending investigation. No petitioner here has asked that the *status quo* be maintained—that is to say no transportation of oil. This is the last thing petitioners want. As the Bureau of Investigation says, some rates must be allowed. The only rates which may be lawfully allowed now are those now on file. It is, therefore, plain that this is not a case for the exercise by the Commission of its power of suspension.

The recent case of *United States* v. *Chesapeake & O. Ry.,* 426 U.S. 500 (1976) is relevant. There the *Commission* conditioned a non-suspension of a filed rate increase on the application of increased revenues to deferred maintenance and capital improvements. The decision was confined narrowly to the precise question presented (page 509). The question was whether by this condition the Commission was interfering in specific financial management of the railroad which it has no power to do. The Court held that this was a proper adjunct to its power to suspend pending investigation, *i.e.,* it prevented irreparable injury. The Court pointed out that the railroad did not have to accept the condition. "They had the option to continue to insist on

an unconditional increase, to submit proof of their reasonableness to the Commission, and, if successful, or if the investigation was not completed within the statutory seven month period, to collect rates based on the new tariff." (page 515). Here as all admit, *this option is not available* to the pipelines. Justices Stevens and Stewart dissented. They thought that the Commission could not lawfully impose even the narrow condition there involved.

8. The Commission May Not Lawfully Enlarge The Petitioners' Discovery Power By Conditions On Non-Suspension.

The Bureau has requested the Commission to condition non-suspension of some imposed lower than filed rate on supplying information in accordance with an elaborate 8-page specification attached to its brief as Appendix D. The Commission has elaborate regulations governing discovery. 49 CFR 1100.55-1100.67. We do not believe that the Commission may disregard its formally adopted regulations or more accurately force the carriers to agree to the Bureau's demands by threat of suspension. If this were not already plain, *U.S.* v. *Chesapeake & O. Ry., supra,* makes it so.

As to the demand that the carriers be required to comply with these special discovery demands within 30 days, we conclude that counsel who makes this demand has never been on the producing end of a document demand. Sohio Pipe Line Company physically could not meet this demand even if it were crystal clear what it called for, which it is not.

Conclusion

No one will be hurt if the Commission now follows its usual practice of permitting initial rates of new pipelines

to become effective pending investigation. It is respectfully submitted that there is no basis whatsoever—legal, moral or equitable—for this Commission to impose on the carriers rates different than those on file.

Respectfully submitted,

SOHIO PIPE LINE COMPANY

By: R. A. JOHNSON
1725 Midland Building
Cleveland, Ohio 44115

JOHN LANSDALE
COX, LANGFORD & BROWN
21 Dupont Circle, N.W.
Washington, D.C. 20036

Attorneys

Dated: June 15, 1977

Protest Reply of Sohio Pipe Line.

AFFIDAVIT

STATE OF OHIO }
COUNTY OF CUYAHOGA } ss:

T. C. Roth, upon his oath, says that he is Manager of Western Crude Oil for Sohio Petroleum Company, a wholly-owned subsidiary of The Standard Oil Company (Ohio), and that the facts hereinafter set forth are true to the best of his knowledge and belief:

The preliminary proposed federal price ceiling for Prudhoe Bay, Alaska, crude oil is over $11.00 at the wellhead. However, for the foreseeable future, the price at which Prudhoe Bay crude oil will sell to refiners and other purchasers when landed on the West and Gulf Coasts of the lower 48 states will be governed by the price of competing sources of crude oil, principally imported crude. At the present time, the approximate price of imported crude of similar quality delivered on the West Coast is $13.00 to $13.50 per barrel. Adjusting that price for differences in quality of Prudhoe Bay crude, the latter would sell for about $12.50 to $13.00 per barrel delivered on the West Coast.

The value at the wellhead of such Prudhoe Bay crude oil would consist of its West Coast delivered price less the costs incurred in the course of transporting the crude from the wellhead to the point of delivery on the West Coast. Using the aforesaid delivered West Coast price range, and assuming a pipeline system tariff of $6.16, a marine transportation cost of $.80 to $1.00 and a fee of $.05 per barrel for payment of the TAPS Liability Fund fee, the wellhead value of a barrel of crude would be about $5.30 to $6.00. If the delivered price of foreign crude oil should vary, the

Protest Reply of Sohio Pipe Line.

wellhead value of Prudhoe Bay crude will vary accordingly, assuming all other elements of the calculation remain the same.

With respect to Prudhoe Bay crude delivered to destinations on the Gulf Coast, the above principles would control. However, foreign crude presently sells for a delivered price on the Gulf Coast of $13.30 to $13.80 per barrel and the cost of transporting North Slope crude from Valdez to destinations on the Gulf Coast is about $3.20 to $3.60 per barrel, resulting in a wellhead value of about $3.50 to $4.40 per barrel.

T. C. ROTH

Sworn to and subscribed before me this 21st day of June, 1977.

GAIL A. WUTZ
Notary Public
GAIL A. WUTZ
Notary Public For Cuyahoga County, O.
My Commission Expires 10/30/78

[Certificate omitted in printing]

Petition of Exxon Pipeline Company for Reconsideration, July 8, 1977.

BEFORE THE
INTERSTATE COMMERCE COMMISSION

[Caption Omitted]

PETITION OF EXXON PIPELINE COMPANY FOR RECONSIDERATION

Pursuant to Commission Rule 101, 49 C.F.R. § 1100.101, Exxon Pipeline Company (Exxon) hereby petitions the Interstate Commerce Commission for reconsideration of its June 28, 1977 Order in the above entitled proceeding and respectfully requests that the Commission modify that Order as it applies to Exxon Pipeline Company. As set forth in detail herein, the Commission's Order is based upon a number of erroneous factual and legal assumptions which, even if the Commissions major premises are accepted on judicial review, must be corrected.

PRELIMINARY STATEMENT

On June 8, 1977, Exxon filed a tariff setting forth an initial rate of $6.27 per barrel to apply to Exxon's transportation of crude oil through the Trans-Alaska Pipeline System (TAPS). Various protests and petitions for suspension and investigation were filed with the Commission on June 15, 1977, to which Exxon and the other joint owners of TAPS responded on June 22, 1977. Following oral argument on June 27, 1977, the Commission, on June 28, 1977, issued the Order which is the subject of this petition.*

* This Order was amended on June 29, 1977, in a "Correction Notice," purporting to cure certain "inadvertent omissions and typographical errors." One of the "omissions and typographical errors" "corrected" required the deletion of three sentences evidencing that the order was based in part on the Commission's views concerning the appropriate return on equity rather than return on valuation, a total departure from past Commission practice.

Petition for reconsideration, Exxon Pipeline.

In its Order, the Commission, *inter alia,* (1) suspended the operation of Exxon's tariff schedule, I.C.C. No. 125, from June 30, 1977, to and including January 29, 1978; (2) ordered an investigation of the lawfulness of the rate contained in Exxon's suspended rate schedule and of the lower interim rate authorized by the Commission; (3) authorized Exxon to file, upon not less than one day's notice, an interim rate not exceeding $5.10 per barrel; (4) ordered that any interim tariff contain a refund provision to the effect that if the interim rate charged exceeds the rate subsequently authorized or prescribed by the Commission, the carrier will refund the difference between the rates with interest; and (5) ordered that the pipeline carriers file, effective on not less than one day's notice, a similar refund provision applicable to the original proposed rates.

The Commission found that, contrary to the contentions of various of the TAPS owners, it had the power to suspend an initial rate, even though the consequences of such suspension could be to preclude any transportation service; that it had the power to establish an "interim rate" without a full hearing, even though the consequences of establishing a rate which was less than the rate finally found to be just and reasonable would be permanently to deprive the carriers of revenues to which they were lawfully entitled; that a method of measuring return, adopted only in a single case, represented the Commission's "historic" method of calculating return, even though Exxon, for one, had been filing rates justified on a different method of calculating return for over 35 years, with the full knowledge of the Commission and without objection from the Commission; and that it could impose refund conditions with respect to

initial rates, even though Section 15(7) of the Act expressly limits this power to *increased* rates.*

This petition, however, does not seek reconsideration of these matters. It is Exxon's position that these fundamental issues were a proper subject for judicial review. In this petition, Exxon, without waiving its right to seek judicial review of such issues, seeks only to direct the Commission's attention to other matters which also render its order unlawful.

It is the position of Exxon that even if the underlying premises of its order are sustained, the Commission erred in the following respects in its June 28, 1977 Order:

1. In determining its lower interim rates, the Commission erroneously based its calculations on the assumption that the throughput for the Trans-Alaska Pipeline during the seven-month interim period will be 1.2 million barrels a day, the current maximum design capacity of TAPS when it is in full operation. (Order, p.5; Appendix 2). To the contrary, the average throughput during the seven-month period when the authorized interim rates would be in effect is anticipated to average no more than 1.05 million barrels a day. As shown below, this error alone makes the proposed interim rates manifestly unreasonable.

2. In estimating the restoration and removal costs which Exxon and the other carriers will incur, the Commission allowed an annual amount calculated by dividing such costs expressed in 1977 dollars by

* It is obvious that a refund condition with respect to an initial rate is far more burdensome than in the case of an increased rate. For an initial rate, a refund condition places the total rate in jeopardy; for an increased rate such a condition applies only to the amount of the increase, and not to the underlying rate.

the 25-year life of the pipeline, wholly ignoring both inflation and the effect of income taxes which must be paid by the carriers on both the funds received and earnings from investment of such funds (Order, p. 6; Appendix 2). By the Commission's own admission, the elimination of an allowance for inflation alone means that this approach understates the amounts that the carriers must accrue; the failure to recognize that these funds are taxable when received and that any earnings on the funds are also taxable grossly magnifies this understatement, and consequently results in an unreasonably low interim rate.

3. Despite a substantial showing by the carriers that a higher return on valuation is justified when interest expense is included in overall return the Commission erroneously and with no justification concluded that a 10 percent return on valuation is appropriate for the TAPS carriers (Order, p. 7). The weight of the evidence before the Commission clearly shows that a higher return on valuation is justified for the TAPS carriers and the Commission had no basis for applying an unrealistic 10% standard to compute proposed interim rates. Moreover, when recognition is given to the reduced throughput achievable in the seven-month period, the $5.10 interim rates does not result in a 10% return, using the Commission's proposed methodology, but instead produces a return of only 8.6%.

In view of these errors Exxon respectfully submits that, at a minimum, the Commission should reconsider its decision in this proceeding and modify its Order in the following manner:

The Commission's determination of an interim rate for Exxon should be based upon: (a) the actual estimated throughput for the seven-month period during which the interim rate would be in effect; (b) a reasonable estimate of restoration and removal costs which includes an allowance for inflation and taxes; and (c) a reasonable rate of return on valuation.

ARGUMENT

I. The Commission Erroneously Based Its Determination Of A Lower Interim Rate On Excessive Estimates Of Throughput During The Interim Period

In its Order, the Commission stated the following (p. 5):

> "The process of arriving at an acceptable interim rate requires two steps. The first is to define the basic carrier data that will be employed, and the second is to perform computations using such data.
>
> "The data that we will employ is set forth in Appendix 2. For the purposes of the present decision, we have, for the most part, employed the figures supplied by the carriers. Appendix 2 displays this data both in total dollars and in dollars per barrel. The conversion to per-barrel figures is based on the assumption that *the normal traffic volume for the beginning years will be 438 million barrels a year (1.2 million barrels a day)*, and that this number will be apportioned among the carriers according to their respective ownership shares in the pipeline." (Emphasis added.)

Thus, using 1.2 million barrels a day as a base, the Commission calculated operating costs, removal costs, depreciation, etc., on a per barrel basis in Appendix 2 and then used the Appendix 2 figures to calculate the proposed interim rate for Exxon of $5.10 per barrel in Appendix 5.

By calculating its proposed interim rate in this manner, the Commission has committed a fundamental error:

Using design capacity figures for system operation during 1978 and following years, the Commission has calculated a rate that will have application, if at all, between July 1977 and January 1978. The result is to grossly overstate the amount of revenue and thus, overstate the return that Exxon will receive if the interim rate of $5.10 per barrel is accepted. A further result of the Commission's error is the anomalous situation in which Exxon receives a lower rate when its costs per barrel are highest. As shown in detail in the verified statement of Ernest C. Terry, attached as Appendix A to Exxon's Reply to Protests, filed June 22, 1977, in computing its $6.27 rate, Exxon did not utilize any 1977 data (App. A, p. 6). As Mr. Terry stated:

> "Because of the uncertainty of initial throughput and operating conditions through year end 1977, a rate based on 1977 was not calculated. A comparable rate for that period would be higher than a tariff rate during a full year of operation."

The $6.27 rate was calculated on the basis of the average design capacity for the years 1978-1981 of 1.24 million barrels per day, reflecting an anticipated expansion in 1981. Mr. Terry did, however, present a forecast of 1977 financial results, estimating throughput for the portion of 1977 in which the pipeline would be operating of 90% of capacity and for 1978 estimating throughput of 95% of capacity to

make due allowance for the uncertainties of start-up, operating conditions, and other factors (App. A, p. 12 and Attachment VII). The anticipated throughput is shown in detail on Table 1 on page 9. The 1977 and 1978 forecasts provide the necessary expense figures and throughput data to permit calculation of a rate for the period July 1, 1977, through January 29, 1978, the period in which the Commission would have its $5.10 interim rate apply.

Using a realistic estimate for throughput during 1977, and January, 1978, Exxon's estimated cost per barrel, before return, assuming *arguendo* all of the Commission's other assumptions are proper, becomes $3.22 per barrel, as compared with the $2.89 calculated by the Commission. Applying the Commission's proposed interim rate of $5.10 per barrel, Exxon's return on valuation, as return is calculated by the Commission in this proceeding, would amount to a mere 8.8%, far below the 10% rate of return which the Commission has found to be acceptable for an interim rate.

On the basis of the Commission's own standards as expressed in this proceeding, i.e., 10% return on valuation, inclusion of interest expense as an element of return, and no allowance for inflation or taxes in calculating removal costs, the minimum interim rate for Exxon during the period from June 30, 1977 to January 29, 1978 should be $5.74 per barrel as shown in Table 2 on page 10.

TABLE 1

Exxon Pipeline Company TAPS Anticipated Revenue Barrels July 26, 1977 Through January 29, 1978

Scheduled Throughput

Date	Thousand Barrels
7-26	128
7-27	160
7-28	176
7-29	182
7-30	182
7-31	185
8-1	185
8-2	190
8-3	195
8-4	200
8-5	205
8-6	210
8-7	215
8-8	220
8-9	225
8-10	230
8-11	235
8-12	240
8-13 through 12-31-77	33,840
Total	37,403
Less: 10% for TAPS downtime, fuel and other factors	3,740
Working inventory in terminal tanks at 3 days throughput	720
Total Revenue Barrels Through 12-31-77	32,943
1-1-78 Through 1-29-78	6,960
Less: 5% for TAPS downtime, fuel and other factors	348
Total Revenue Barrels 1-1 through 1-29-78	6,612
Total Revenue Barrels During Period	39,555

TABLE 2

Minimum Rate for the Period June 30, 1977 through January 29, 1978 Using ICC Method Adjusted to Reflect Anticipated Throughput

	M $	$/bbl.
Return on Valuation @ 10% (includes both net income after taxes and gross interest expense)	$ 99.8	$2.520
Operating Expenses	25.8	.651
Ad Valorem Taxes	14.4	.363
Book Depreciation	36.6	.924
TAPS Dismantling	4.3	.109
Provision for Income Taxes	46.6	1.177
Total Revenue	$227.5	$5.744

If Exxon should choose to file an interim rate at the level authorized by the Commission, it is clear that Exxon would suffer an irreparable revenue loss of not less than $25.5 million due to the Commission's error. Exxon submits that the Commission has an obligation to correct this fundamental error and adjust its proposed interim rate accordingly.

II. The Commission Erroneously Calculated Removal Costs Without Any Allowance For Inflation Or For Income Taxes On Funds Received And Reinvested By The Carriers

On pages 5 and 6 its Order, the Commission stated:

> "Of the items set forth in Appendix 2, substantial questions have been raised at this stage of the proceeding particularly with regard to removal and restoration costs and depreciation. . . .

> "For removal costs, we have used the same per-barrel allowance for each carrier, because we see no basis for cost differences among the carriers on this item. Our allowance is based on a simple amortization without inflation or discounting. While this approach may somewhat understate the amounts that need to be accrued, the magnitude of the discrepancy would not be great in terms of the overall tariff computation. It may well be outweighed by overstatement in the depreciation charges."

The Commission thus essentially adopted the approach advocated for removal costs by the Bureau of Investigations and Enforcement. As Exxon pointed out in its Reply in this proceeding (pp. 33-36), this simplistic approach has no basis in fact and makes no sense. It is a fact that Exxon is going to have to pay these removal costs. It is also a fact that Exxon will have to pay income taxes on both the funds received and the interest received from investing these funds for the purpose of paying the removal costs. And it is undeniably true that these removal costs will be subject to inflation over the next 25 years. Yet, in the face of these facts, the Commission has somehow concluded that removal costs allowed in the carriers' expenses should be calculated by simply taking the estimated total removal costs for TAPS in 1977 dollars, dividing by 25 years and dividing again by the respective carriers' proportionate share of TAPS ownership. This approach is so remote from reality that it is totally indefensible.

Exxon calculated that $16.4 million must be collected annually in order for Exxon to meet its removal obligations in 2002. In making its calculation, Exxon assumed that both the rate of escalation of costs over the 25-year period

and the rate which it can earn on the after-tax amounts invested will be 6% (also after taxes). Investment of the after-tax funds resulting from this sum will yield approximately $466 million by the year 2002, slightly less than the present estimate of Exxon's share of the total restoration and removal costs after giving full effect to the Federal tax deduction Exxon will be entitled to take when the expenditures are made.

The Commission's approach by contrast, would make available to Exxon only $8.4 million per year. Investing the sum remaining after taxes ($3.95 million) at 6% for 25 years would produce a total of only about $233 million in 2002, or only about one-half of the $466 million Exxon will require.

The Commission's treatment of removal costs is thus completely unrealistic. And it is no excuse to say that even though this treatment "may" understate the amounts needed, it "may well be outweighed" by overstatement in the depreciation charges. The Commission on one page (p. 5) concludes that the depreciation charges used by the carriers have not been shown to be wrong and then on the next page attempts to discount those charges by using them as a justification for understating removal costs. Such treatment is not only inconsistent and unfair, but it also reflects a disregard for the facts presented to the Commission with regard to removal costs and associated expenses.

In Appendices 2 and 5 of its Order, the Commission should include $16.4 million as on an annual basis removal costs for Exxon, which, when prorated on the basis of an average throughput of 211,000 barrels per day for the interim period, results in an expense of $0.205 per barrel, $0.109 higher than the figure used by the Commission. This

modification of the Commission's figures, coupled with the adjustment discussed in Section I above, indicates that any interim rate authorized for Exxon during the period from July 1977 to January 29, 1978 should be no less than $5.85 per barrel.*

III. The Commission Unjustifiably Adopted 10 Percent Return On Valuation As A Limit In Computing Its Authorized Interim Rates

In discussing its determination of authorized interim rates, the Commission wrote the following (pp. 7-8):

> "At the outset, we have questions about the appropriateness of an 8 percent return in this instance, where annual interest rates generally exceed 8 percent. The small margin of earnings in excess of interest that would result is demonstrated in Appendix 4. . . .
>
> "It should be noted that the 8 percent on valuation standard arose in the early 1940's, when capital costs were substantially lower than they are today. It could continue to provide a substantial return on original investment to established carriers, whose valuations have risen well above their actual investment because of inflation. In the case of the TAPS carriers, however, their property was constructed so recently that valuation is little higher than actual cost, and an 8 percent return on valuation becomes quite deficient.
>
> • • •

* The figures shown in Table 2 remain the same in this calculation except that the per barrel TAPS dismantling expense increases to $0.205, and the provision for income taxes is increased to $1.187, increasing total revenue required, i.e. the rate, to $5.85.

"For the purposes of the present decision, we have determined that the standard of a 10 percent return on valuation for petroleum products pipelines inappropriate for the TAPS carriers. Our selection of the 10 percent return on valuation standard is based primarily on two factors. One is that the magnitude and inherent attributes of the TAPS project produce a higher risk factor than is normal in crude oil pipeline operations. Many of the construction features are being tested for the first time. Geographic terrain, environmental and temperature problems, possible earthquakes, vulnerability to sabotage, future oil pricing policies, and regulatory uncertainty are among the factors to be considered. Moreover, a 10 percent return on valuation appears generally sufficient to cover estimated capital costs. As previously noted, an 8 percent return on valuation produces generally insufficient returns on equity.

• • •

"Although the 10 percent return on valuation appears suitable for present purposes, we stress that it is not intended to be a general standard nor to be a prejudgement of criteria to be used upon the conclusion of the investigation in these proceedings, nor is it in any way to be considered a prejudgement of the issues in Ex Parte No. 308."

The factors listed by the Commission in deciding to allow a rate of return on valuation for the TAPS carriers, on an interim basis, higher than that traditional for crude oil pipelines are impressive and unassailable. However, the Commission's determination to set the level of authorized interim rates on the basis of a flat 10% return on valuation

is contradictory to the bulk of the evidence before the Commission. The eight joint owners of TAPS filed initial rates which would result in returns on valuation, as return is calculated by the Commission, ranging from 12.4% to 13.5% (See Order, App. 3). Exxon's proposed rate of $6.27 per barrel, based on 1978-1981 estimated costs and throughput, would result in only a 12.5% return on valuation according to the Commission's own calculations. In support of that kind of return, Exxon referred to the sworn testimony of Raymond B. Gary, a Managing Director of Morgan Stanley & Co., and Dr. Ezra Solomon, Dean Witter Professor of Finance at the Graduate School of Business of Stanford University, filed in Ex Parte No. 308, *Valuation of Common Carrier Pipelines.* (Exxon Reply, App. C and D) These two witnesses, each a recognized expert in the field of finance, employed different techniques to determine the minimum overall rate of return on valuation to provide total capital needs (i.e., both debt and equity) required for a *minimum risk* oil pipeline. Mr. Gary concluded that 13-14% was minimum return on total valution for an oil pipeline today. Dr. Solomon concluded that a return on total valuation of 13 to 13½ percent was appropriate for pipelines of minimum risk.*

The various protestants simply asserted, on "historic" grounds, that, even where interest is recovered in return on valuation, the total return should be somewhere between 8% (Alaska) and 10% (Bureau).

In light of the factors requiring a higher than normal rate of return which the Commission expressly recognized and the overwhelming weight of the testimony that a

* Arco Pipe Line Company also submitted statements by two expert witnesses supporting its proposed initial tariff which would have produced a return on valuation of between 12.2 and 12.4% (*see* Arco Reply, App. D and E).

return on valuation in the range of 13-14% should be considered a *minimum,* the Commission's use of the 10% return figure in calculating its proposed interim rates is clearly unjustified. Recognizing the irreparable losses the TAPS carriers will incur if the authorized interim rates are eventually found to be too low, the more reasonable course of action for the Commission to have taken would have been to calculate interim rates, if any, on the basis of a 13-14% return on valuation, pending more detailed examination in the investigation instituted.

After making the adjustments in throughput for the interim period and removal costs, discussed in Sections I and II above, the interim rate of $5.10 for Exxon authorized by the Commission produces only an 8.6% return on valuation, a figure which by the Commission's own standards is deficient. For the seven-month period, Exxon's proposed initial rate of $6.27 per barrel results in a mere 10.8% return on valuation, still low according to the bulk of the evidence presented in this proceeding.

Exxon submits that the Commission should reconsider its determination that 10% return on valuation is adequate for the purposes of calculating interim rates and should modify its Order to reflect a return on valuation in the range of 13-14% for interim rates.

CONCLUSION

Because of the errors contained in the Commission's Order described above, Exxon respectfully submits that the Commission should reconsider its decision in this proceeding and modify its Order by authorizing an amended interim rate for Exxon.

Respectfully submitted,

EXXON PIPELINE COMPANY

By RICHARD J. FLYNN

FRANK L. HEARD, JR.
P.O. Box 2220
Houston, Texas 77001

LEE A. MONROE
JOSEPH B. TOMPKINS, JR.
Sidley & Austin
1730 Pennsylvania Avenue, N.W.
Washington, D.C. 20006

Of Counsel

Its Attorneys

[Certificate of Service Omitted]

ICC Order of July 11, 1977 Setting Case for Hearing.

ORDER

AT A GENERAL SESSION OF THE INTERSTATE COMMERCE COMMISSION, HELD AT ITS OFFICE IN WASHINGTON, D.C., ON THE 7TH DAY OF JULY, 1977.

INVESTIGATION AND SUSPENSION DOCKET NO. 9164

TRANS ALASKA PIPELINE SYSTEM
(Rate Filings)

NO. 36611
TRANS ALASKA PIPELINE SYSTEM
(Rules and Regulations)

By Commission orders dated June 17, 1977 and June 28, 1977, investigations were instituted in the above matters. The carriers' initial rate tariffs were suspended without prejudice to the filing of interim rates. The order dated June 28, 1977 stated that the proceedings would be handled together because of the close interrelationship of the rate filings and the applicable rules and regulations.

Upon consideration of the record, we find that this matter should be referred to an Administrative Law Judge for hearing. We further find that due and timely execution of our functions under Section 15(7) imperatively requires the omission of an initial decision by the Administrative Law Judge.

It is ordered, That the above-entitled proceedings be referred to an Administrative Law Judge for hearing commencing with a pre-hearing conference on July 19, 1977,

ICC Order.

at 9:30 a.m., Local Time, at the Offices of the Interstate Commerce Commission, Washington, D. C.

In these proceedings the Commission intends to construe liberally the discovery rules (Rules 56 through 67 [1] of the General Rules of Practice, 49 CFR 1100.56 through 1100.67). The Administrative Law Judge may find it necessary to establish special procedures and deadlines for discovery to permit the fullest possible development of the record in the public interest because of statutory time limits.

By the Commission. (Commissioner Hardin not participating)

(Seal)

H. G. Homme, Jr.
Acting Secretary

1. Rules 54-65 of the Commission's Revised Rules of Practice, which are scheduled to become effective July 19, 1977.